

A Contingent Examination of Strategy-Cost System Alignment: Customer Retention and Customer Profitability Analysis

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Abstract

This research undertakes a contingency theory examination of strategy and cost system alignment based on customer retention and customer profitability analysis. Previous research and consultancy advice has promoted the benefits of a firm following a customer retention strategy. They claim that in order to support the strategy a firm should have a customer profitability analysis system in place. Yet often what is prescribed as good practice is not observed in firms. This inconsistency is explained using contingency theory.

Initial qualitative evidence was collected from four industry sites to determine whether the above strategy-cost system alignment was present. An analysis of these findings suggested that the customer retention-customer profitability analysis system relationship was contingent on a range of factors. As a result, a contingent theory of this relationship was developed from the four sites, and this theory was then tested in a survey of 862 people from 431 firms.

The survey results provide support for the propositions developed from the qualitative evidence. It is likely that firms will follow multiple operational marketing strategies and have cost management systems in place to support those strategies. Although customer retention is a very important operational marketing strategy, a significant number of firms do not have customer profitability analysis systems in place to support the strategy. Many contingent factors were identified. Customer profitability analysis implementation is dependent on industry type;

size; the difficulties involved in determining customer costs; whether the organisation has a champion for the system; the relationship between the marketing and accounting functions in a firm; and the available labour resources to facilitate implementation.

Further, it is apparent that customer profitability analysis information is not essential to support a customer retention strategy. Customer revenue information can be substituted and the firms are satisfied with the level of management accounting system support for their operational marketing strategies.

However, many respondents see the value of customer revenue, customer cost and customer profitability information, providing opportunities for future design of such systems as well as research into their development.

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Chapter One: Introduction

Introduction

“Customer focus stands out as the critical success factor of the 1990s” (Timewell 1994, 29).

The primary focus of traditional management accounting has been product costing (Hansen and Mowen 2000). This predominance has survived despite the changing nature of the focus of business in the global economy (see Young and Selto 1991). The three most important general management priorities that faced organisations in the 1980’s were (in ranked order): 1. Cost management/cost control; 2. Growth and 3. Profitability. Customer profitability/satisfaction ranked fourth (Foster and Young 1997). By the mid 1990’s the three most important issues had changed dramatically. They were: 1. Customer profitability/satisfaction; 2. Cost management/cost control and 3. Quality. Also in the cost/management and cost control area, customer profitability was ranked as the second most important cost issue (Foster and Young 1997). Despite this change in business focus over the past two decades, management accounting has been slow to change its basic premises (Young and Selto 1991).

Shields (1997) reports that there are no articles in management accounting research journals which cover the issues of customer profitability/satisfaction. Yet Foster and Young (1997, 69) state “customer profitability/satisfaction...clearly has substantive accounting content. It involves challenging issues relating to customer revenue analysis and customer cost

analysis...The upside of making substantive contributions on a topic of such high importance to managers makes this an area warranting significant research.”

The Research Topic

The objectives of this research are to:

1. To identify company perceptions of the level of importance of a Customer Retention Strategy
2. To attain insights into CPA adoption rates
3. To identify some of the contingent factors that might affect CPA adoption rates
4. To gain some perspective on the extent to which marketing managers are satisfied with the management accounting support for the operational marketing strategies.

This research examines the role that management accounting information plays in relation to marketing strategy, with a particular focus on operational marketing strategy in relation to customers and customer information systems. Literature from two distinct fields is combined, those of marketing and management accounting. There has been a plea, in the management accounting literature in particular, for such a combination. Foster and Gupta (1994, 43) comment that there has been “minimal integration between several literatures”, with particular reference to marketing, management accounting and cost management, even though “[a] pivotal purpose of marketing is increasingly being viewed as the attraction and retention of profitable customers [and the] emphasis is on profitable customers and not just sales” (Foster and Gupta 1994, 46).

These comments were reiterated in New Zealand recently: “Too many businesses treat production and marketing as separate functions, when in fact they should be examined together to get a better picture of cost management, believes Mahendra Gupta” (“Profiting...”1996, 30). Tudor and Wilson (1983) also argue for a greater understanding and co-operation between the accounting and marketing functions.

As a result of the perceived need for research examining the combination of marketing and management accounting, this research has chosen to examine the relationship between marketing strategy and management accounting information, with a particular focus on customer retention and customer profitability analysis. Many authors have argued that if firms are to follow a customer retention strategy, then that strategy should be focused on profitable customers (Shapiro et al. 1987, Petty and Goodman 1996, Kirby 1996, Timewell 1994, Stuchfield and Weber 1992). In order to focus the strategy, a customer profitability analysis system should exist in order for the most profitable customers to be identified (Shapiro et al. 1987).

In making an assessment of the relative importance of customer retention as a strategy, research has sought to relate the strategy to measures of firm performance. There has been some examination, particularly in the marketing literature, of the relationship between customer retention and firm profitability. However Foster and Gupta (1994) criticise this research for its global customer focus. In a footnote they refer to a working paper by Anderson and Fornell

(1993), which states that: “marketing literature provides tests of the linkage between customer satisfaction and profitability...however the primary focus of this research is on the **aggregate profits** across customers rather than the profitability of individual customers” (Foster and Gupta 1994, footnote 15, 58 emphasis added). This criticism places the current research in context. There is a need for the effect of marketing relationships to be examined from a management accounting perspective.

In addition, it has been commonly expressed in the customer profitability analysis literature that information from such systems will provide better information for decision making, but to date there has been little empirical examination of this advocated position (Foster and Gupta 1994, 58). This research will contribute empirical evidence.

“Strategy theoreticians as well as management accounting and control academics have argued that control systems should be differentiated in accordance with the strategy of the firm” (Bruggeman and Van der Stede 1993, 206), that is, control system design ought to be driven by strategic intent. As this research seeks to examine the relationship between strategy and management accounting information systems the literature relating to strategy and management control system design is described.

The thesis then moves from the general to the specific by singling out one particular operational marketing strategy, customer retention, and one management accounting information system, customer profitability analysis. A

prescriptive analysis is presented which shows (predominantly from non-academic literature) that a firm which follows a customer retention strategy should have a customer profitability analysis system in place to support that strategy.

However, often what has been prescribed as good practice is not applied in firms. Much of the research in management accounting has relied on contingency theory to explain the divergence between theory and extant practice. It has focused particularly on the areas of performance evaluation and management control, with very little research in the field of cost management (Anderson and Lanen 1999). The contingency literature has sought to relate strategy to management control but much of this analysis has focused on typologies (like Miles and Snow's (1978) defender-analyser-prospecter and Porter's (1980) cost leader-differentiator).

This research seeks to extend the contingency literature in management accounting by examining whether marketing strategy-customer retention, and cost management-customer profitability analysis are contingent on specific organisational characteristics. Previous research has focused on internal and external characteristics including industry, technology, size, culture and strategy (Bruggeman and Van der Stede 1993). These characteristics, and new ones (discussed in detail in chapter fifteen), will be used to explain the findings of this research.

Contingency research in management accounting has been criticised, particularly for its focus on hypothesis testing. Otley (1980) and Otley and Pollanen (2000,

13) suggest a “greater emphasis [be placed] on case-based...work” in contingency studies. Therefore this research began using case based contingency analysis in four firms. As a result of this initial analysis, several factors became obvious as impacting on the specific use of customer profitability analysis to support a firm’s marketing strategy. A theory of the relationship between operational marketing strategy and customer profitability analysis was established from these case studies. In order to complete the research cycle, theory generation to testing, the theory was tested through a survey of 431 New Zealand firms.

Contribution to Knowledge

Doctoral research is required to make an original contribution to knowledge (Phillips and Pugh 1994). This research contributes to knowledge in the following ways. The relationship between operational marketing strategy and management accounting system use, with a particular focus on customer strategies and customer information systems, is further developed. This is achieved through an examination of the use, and importance of, customer profitability analysis systems to marketing strategy, which has not previously been assessed. This research therefore answers the call for a combination of the literatures of management accounting and marketing.

In addition, the contingency research in management accounting will be expanded in two ways. Firstly, a new strategy-cost accounting relationship is examined which has not been the focus of prior research. Previous research has focused primarily on business unit level strategy, rather than operational strategy. Where

there has been a foray into operational strategy, the focus has been on manufacturing, not marketing (Langfield-Smith 1997). Secondly, previous work has focused on management control systems, rather than cost systems. Finally, the research responds to the call for the case based method to be used in contingency research by the use of qualitative evidence which was collected in the first instance, yet testing the theory has allowed for the entire research cycle to be completed. Langfield-Smith (1997) believes that both methods are still very relevant for research in the management control system-strategy paradigm.

Thesis Layout

Chapter two is devoted to the literature examining the relationship between strategy and management control systems using a contingent approach. The chapter provides a chronological précis of the relevant existing strategy/structure literature. This shows that there is no literature examining the relationship between customer retention and customer profitability analysis using a contingent approach. However patterns which emerged during the qualitative data collection phase for this thesis provided an opportunity to theorise about the above relationship being contingent on specific organisational and industry characteristics.

Chapters three through five develop a prescriptive examination of the relationship between customer retention and customer profitability analysis. Chapter three

presents the literature describing what is meant by a customer retention strategy¹. It focuses on defining customer retention and the importance of measurement to successful retention.

Chapter four provides an account of the literature relating to customer profitability analysis. It provides a theoretical framework, tracing the evolution of the development of such systems. An examination of how the information from customer profitability analysis systems can be used to support a firm's marketing strategy is presented.

When making an assessment of the relative importance of customer retention as a strategy, research has sought to relate strategy to firm performance. Chapter five discusses the relationship between customer retention and firm performance. To date support for the relationship is either anecdotal, provided by consultancy firms, or the academic examinations take a global view, not considering the role of management accounting information systems, such as customer profitability analysis.

Chapter six discusses the research method used to undertake this research. In stage one of this research four case studies were used. The case study strategy is described, as is the process of gaining access, and the sites. The chapter also

¹ Customer retention is the strategy which is the focus of this research when it was started in 1996. Today customer retention strategies have been incorporated in an overall marketing philosophy termed Customer Relationship

describes a novel research technique used for this research, namely electronic interviewing. Its strengths and weaknesses are discussed.

It then describes the method used for stage two of this thesis, namely a survey of 431 firms which tested propositions developed from the qualitative evidence and the contingency literature.

Chapters seven through ten document the evidence collected for each of the four sites. Chapters eleven and twelve provide cross-site analysis covering the three themes which were presented in the literature chapters three through five. Chapter thirteen provides an interpretation of the major findings of the qualitative evidence, relying on contingency theory to provide an interpretation of why the firms had differing approaches to the relationship between the retention strategy and the information system used to support it. At the end of this chapter, five propositions are developed.

Chapter fourteen completes the research cycle. The results of the survey are provided which explores the extent to which the propositions developed, are supported on a sample of 431 New Zealand firms.

Management (CRM). However customer retention, lies at the heart of CRM. You must be able to retain customers to manage them. CRM is not the focus of this research, but CR is.

Finally, in chapter fifteen, conclusions are drawn, implications for further research and practice are provided, and limitations are discussed. A summary concludes the thesis.

Chapter Two: Strategy and Management Control Systems

Introduction

“The...universalistic approaches to research on control system design are too simplistic to explain the operation and effectiveness of control systems...the contingency theory approach to research on management control systems...provides insights on the array of management control systems found in practice and should help to increase the effectiveness of organizations by improving the control system choice” (Fisher 1995, 44).

The purpose of this chapter is to introduce the management accounting contingency research paradigm. The principal aim of a contingent approach to management accounting research is to identify specific accounting systems aligned with a set of organisational circumstances (Otley 1980). Management accounting systems are “a function of context...determined by external environment, history and other organizational contingencies” (Anderson and Lanen 1999, 380).

The contingency approach to management accounting research became a dominant paradigm in the 1970's (Otley 1980). The literature, relating predominantly to control systems (budgets in particular) provides a range of contingent factors.

Firm strategy appears to impact on management accounting system design – “the endogenous factor most commonly examined in relation to management accounting practices is firm strategy” (Anderson and Lanen 1999, 381). This

literature shows that most existing studies have focused on business unit level strategy rather than operational strategy. Where the literature has moved to an analysis of operational strategy it has focused on manufacturing strategy, rather than marketing strategy.

The other side of the relationship is the type of management control system analysed.

“Of the three broad areas of management accounting typically included in introductory texts (planning and control, cost management, and performance appraisal), planning and control and performance appraisal are the subjects of most contingency research” (Anderson and Lanen 1999, 381).

However, cost management systems have remained largely ignored. Therefore this chapter provides the motivation for undertaking an examination of the alignment of a marketing strategy and a cost system – namely customer retention and customer profitability analysis respectively – which will be described in chapters three through five.

Literature Review

“The contingency approach to management accounting is based on the premise that there is no universally appropriate accounting system which applies equally to all organisations in all circumstances” (Otley 1980, 413). A researcher can use contingency theory in two ways: either, prior to undertaking the research, there can be a clear hypothesis that attempts to assess the impact of hypothesised

contingent factors; or, after the research has been undertaken, contingency theory can be used to explain the inconsistent results (Otley 1980, 414).

Otley (1980) originally classified the contingency literature existing at that point into three categories: firstly that which relies on contingency theory to explain inconsistent results; secondly that which undertakes hypothesis testing of contingent factors and finally, theoretical formulation. Otley (1980, 417-418) argued that “there are few empirical studies that explicitly adopted a contingency approach prior to collecting data [and] all that can be concluded is that there is some degree of association between some hypothesised contingent variables and the existence of certain features of an accounting system.”

Later Fisher (1995, 34) classified the existing contingent control studies into four levels. Level one studies correlated one contingent factor with one control mechanism. Level two studies examined the joint effect of a contingent factor, a control mechanism and an outcome variable. Level three researched the joint linkage between multiple control mechanisms, a contingent factor and a firm outcome. Finally level four studies used a multiple-contingency approach.

Fisher (1995) calls for further research particularly in areas three and four. Anderson and Lanen (1999, 380) could be considered as a level four paper as it did: “extend the...body of literature which examines cross-sectional differences in management accounting practices of firms that have different endogenous, organizational contingencies.”

The first contingency based studies examined reliance on performance measures. The seminal works are Hopwood (1972) and Otley (1978). The studies concluded different universal results in relation to budget style and performance. Organisational structure became the explaining variable for the differences in the results between these two early studies, which used cost centres and profit centres respectively.

A plethora of studies followed, particularly from Australian authors (Brownell 1982; Brownell 1985; Brownell and Hirst 1986; Brownell and Dunk 1991). Recently, Otley and Pollanen (2000) replicated these studies and found conflicting results, however this contingency based research is not the subject of this thesis.

Other early studies tried to relate the management control system attributes to organisational size. Bruns and Waterhouse (1975) and Merchant (1981) found the size² led to more advanced management accounting control systems being in place.

Since these initial studies several contingent factors have been identified as influencing management accounting system design and use including technology, task variety, task knowledge, the effect of organisational structure and context, and the effect of the environment and decision making style (Otley 1980). Later research expanded on these categories. Fisher (1995) provides a list of those

² This research will examine whether organisational size is related to customer profitability analysis (CPA) adoption.

factors which include: 1. External environment; 2. Competitive strategy and mission - Porter (1980), Miles and Snow (1978) and product life cycle; 3. Technology; 4. Unit, firm and industry variables; 5. Knowledge and observability factors.

The stream in the contingency based work relevant to this thesis examines strategy and structure. A chronological summary of the major works is now presented.

Strategy and Structure

Strategy: “A pattern in a stream of decisions” (Mintzberg, 1978, 935)

Contingency based studies in the 1980’s and 1990’s sought to relate strategy to organisational structure. The literature has focused primarily on strategic business unit or corporate level strategy using strategy typologies.

Gupta and Govindarajan (1984) collected data from 58 strategic business units and categorised those units strategies as either build or harvest. They then sought to provide empirical support to the normative position that a manager’s characteristics should be aligned with the units strategic mission. The study found that “Greater marketing/sales experience, greater willingness to take risk, and greater tolerance for ambiguity contribute effectiveness in the case of build SBUs” (Gupta and Govindarajan (1984, 38).

Govindarajan and Gupta (1985) sought to examine the relationship between strategy, compensation and firm performance at the strategic business unit level. The research examined build versus harvest strategies and found that firms following a build strategy placed greater reliance on long-run criteria and more subjective assessments for determining compensation, yet the opposite was effective for units following a harvest strategy.

Gupta (1987), using data from 58 SBU's, sorted the units by strategic mission and competitive strategy using Porter's (1980) typology. The study then sought to examine the impact of different types of corporate-SBU relations. The research found that openness in corporate-SBU relations is supportive at the build end and differentiation; subjectivity in performance assessment makes a positive contribution at the build end and differentiation; decentralisation is not necessary at the build end but is supportive of differentiation.

Simons (1987, 358) aimed "to determine the nature and extent of differences in the control systems of firms with different business strategies." The paper relied on the Miles and Snow (1978) Typology and studied four industries. The hypothesis was the control system attributes do not differ between prospector and defender firms. They found that control systems do differ among these groups.

Simons (1990) extended the strategy/structure literature. In a comparison of two firms he showed that structure could influence strategy *formation* as well as strategy *implementation*.

Dent³ (1990, 3) provides a normative account of areas for future research in accounting and strategy. The paper advocates research in three key areas: 1. the relationship between organizations' control systems and their strategies; 2. accounting systems and the process of strategic decision making and 3. connections between control systems and the emergence of strategic change.

Simons (1995, 153) believes that:

“control of business strategy is achieved by integrating the forces of belief systems, boundary systems, diagnostic control systems, and interactive control systems.”

Business strategy - a plan of action - can be either intended, emergent and/or realized (Mintzberg 1978). A strategy is realised when it is achieved and as such outcomes can be observed. An intended and realised strategy can be assessed using diagnostic control systems (Simons 1995). A diagnostic control system measures the performance of strategy relative to a plan,⁴ “focus[ing] attention on the implementation of intended strategies” (Simons 1995, 157).

Emergent strategies are those which develop from managers who are given the opportunity to be creative and innovative. These strategies are not necessarily intended. To control emergent strategies requires the integration of the belief systems; boundaries must be established to allow, but also to limit, individual

³ The paper provides strong support for further research on the “interface between accounting and strategy, ...as yet, underdeveloped.” (Dent 1990, 21). However this paper is now over 10 years old.

⁴ This forms the basis of this research. The “intended – realised” strategy is the operational marketing strategy and the diagnostic control system is the customer accounting system in use.

freedom, and an interactive control system will “stimulate and guide emergent strategies” (Simons 1995, 156.)

Simons (1995) argues that to successfully control business unit strategy all four forces, namely belief systems, boundary systems, diagnostic and interactive control systems, must be integrated and controlled, with a focus on strategy at the senior management level. He comments that:

“At the business level, the strategy of the firm is the aggregation of strategies that affect financing, marketing, production, distribution, government relations, and so forth” (p.155).

For the purposes of this research, one of the aggregate strategies – an operational strategy - is to be examined, namely marketing strategy, with a particular focus on customer retention. This is an intended strategy – that is, the strategy is taken as given, and hence can be assessed using a diagnostic control system. In this case the control system is the customer accounting system, with a particular focus on customer profitability analysis.

Langfield-Smith (1997) provides a critical appraisal of the strategy–management control system literature. She states that:

“Much of the empirical research in this area follows a contingency approach and involves a search for systematic relationships between specific elements of the MCS [Management Control System] and the particular strategy of the organization.” (Langfield-Smith 1997, 207)

The paper categorises existing research into three groups. The first research was normative – studies which stated what ought to be; the second was empirical

research which sought to statistically test the relationship between specific parts of the management control system and the strategy employed and to provide a measure of success. More recent literature has been case based, with the aim of gaining a more in depth understanding of both strategy formulation and management control use.

A key fact revealed by Langfield-Smith (1997) is that the existing research has focused on business strategy at the senior management level. Langfield-Smith (1997) notes that the relationship between operational strategy and management control system use has been covered in non-academic publications or from a normative point of view in academic circles. Although she then describes two initial academic studies that have been undertaken on operational strategy, they focus on manufacturing strategy, not marketing strategy, thus there is great opportunity to study further the relationship between strategy and management control system use.

In particular, she recommends that:

1. Research should examine operational strategy (p.228);
2. Both case-based and survey work should continue to be used (p.228);
3. Not only the existence of controls, but their use and importance should be examined (p.226);
4. Studies should have a measure of effectiveness to determine the fit between management control system design and strategy (p.226).

The state of the existing literature on management control system use and strategy motivates this research. What it aims to do is to isolate an operational strategy, namely marketing strategy, with a particular focus on customer retention, and examine whether a diagnostic control system is in use to support that strategy, namely a customer accounting system, with a particular focus on customer profitability analysis.

As Langfield-Smith (1997) argues that both case based and survey work are still applicable, this research was undertaken in two stages. Firstly qualitative evidence was collected using personal and email interviews. As a result of this information, a theory was developed and tested on a sample of 431 firms.

As Langfield-Smith (1997) claims that it is important to not only assess whether controls are used but whether they are important, survey respondents were asked to provide evidence of use and importance in relation to customer accounting systems. Finally, to satisfy the fourth requirement, survey respondents were asked to provide an assessment of their satisfaction with the customer accounting systems.

Fisher (1995) also provides support for the importance of this thesis. He makes it clear that the contingent literature in relation to other strategies, for example customer retention, has not been examined. Also Fisher (1995) provides a synthesis which shows that the focus has been on management control systems rather than costing systems. An important gap is identified in the literature which drives the focus of this research, that is the need for contingent research to

consider alternative strategies and alternative management accounting systems, other than control systems.

A recent study Anderson and Lanen (1999) undertakes field studies in fourteen Indian firms investigating how the management accounting systems changed in relation to India becoming a more open economy in 1991. It showed that competitive strategy, economic and political upheavals and international outlook were important contingent factors in explaining the differences in management accounting practices.

Guilting (1999) undertook contingency based research in relation to competitor-focused accounting (CFA) (which does not include customer accounting). The research found that there is scant research on CFA practices, yet the use of these practices was relatively high. The paper also related CFA practices to competitive strategy, strategic mission and company size.

Guilting (2002)⁵ is the first paper to examine customer accounting practices strategy. The paper found that marketing orientation was positively related to the perceived merit of customer accounting practices. Yet the main finding of the paper is that there is great opportunity for research into the areas of customer

⁵ Yet this paper was published five months after this thesis was originally submitted. It clearly supports the innovative element of this work. This research was being undertaken concurrently, and it states very clearly the dearth of empirical research in the customer accounting area during this time, and still now. It also explains why I do not embark on hypothesis testing, as the paucity of prior research made this difficult. At the exploratory stage of research, evidence gathering and the development of propositions is what can be expected.

accounting and the paper hopes to be “a catalyst for further research into the hitherto largely uncharted waters of CA” (Guilding (2002, 57).

Criticisms of Contingency Based Research

Otley (1980) and Otley & Pollanen (2000) criticise existing contingency research for its method, namely exclusively hypothesis testing. They argue for “a greater emphasis [to] be placed on case-based” investigation, in single organisations. As the existing research in the area of customer retention and customer profitability analysis is predominantly prescriptive and of a non-academic nature, this research sought to investigate whether the operational strategy-management control system alignment is contingent on specific organisational characteristics, using qualitative evidence. From this evidence, and the existing scant literature on the topic, propositions were developed, on this strategy-management control system alignment which were analysed for their level of support on a wider population of 431 firms.

Contingency Research Used Here

Several authors argue that contingency theory needs to develop in three areas.

Firstly, research should try and view alternative management accounting systems:

“Of the three broad areas of management accounting typically included in introductory texts [planning and control, cost management, and performance appraisal], planning and control and performance appraisal are the subjects of most contingency research” (Anderson and Lanen 1999, 381).

In an earlier paper, Young and Selto (1991) concurred, stating that no papers had been devoted to cost accounting and cost allocation. Anderson and Lanen (1999) is one of the first studies to consider “a broad range of accounting practices” yet it did not consider customer profitability analysis, nor did it consider alternative strategies to those which had already been examined. Further Guilding (2002) as described above makes a very strong and recent case for the need for research into customer accounting practices. Therefore this research seeks to examine whether customer profitability analysis help a firm achieve a customer retention strategy and under what conditions (contingent factors) does a firm implement a customer profitability analysis system.

Further, research should identify contingent factors that have not previously been the focus of research (Fisher 1995). Finally the method used for contingent based research needs to be changed from “hypothesised contingent factors for empirical testing” (Otley and Pollanen 2000) to case based investigation as also called for by Fisher (1995) and Bruggeman and Van der Stede (1993).

At this point, the contingency literature has focused predominantly on management control and performance evaluation and the strategy typologies (like Miles and Snow’s (1978) defender-analyser-prospecter and Porter’s (1980) cost leader–differentiator). Bruggeman and Van der Stede (1993, 205) classify these as “quite simple strategy typologies.”

The relationship between customer retention and customer profitability analysis has not been examined using a contingent approach. Yet the literature presented

in chapters three through five will show that the strategy–structure relationship under investigation should be contingent, as previous strategy-structure research has shown.

Firstly, it is likely that customer retention, although prescribed as such, will not be a universal strategy, but be industry dependent. Secondly, not all firms will have a customer profitability analysis system. These systems are complex. As Foster and Gupta (1994) argue it is difficult to calculate customer revenues and costs, and this may be contingent on the products and services sold by a firm.

Fisher (1995, 32) states that “the contingent control literature is based on the premise that a correct match between contingent factors and a firm’s control package will result in desired outcomes (i.e. higher performance)”. Yet a review of Fisher (1995, Exhibit 6, 36-38) shows no studies which linked marketing strategy with cost management systems.

In chapters three through five it will be prescribed that a firm following a customer retention strategy should have a customer profitability analysis system in place, yet contingency research has argued that:

“control systems are substitutable...some control systems are used in a complimentary way and others are used as substitutes, depending on the firm’s contingent factors and ...strategy...The conflicting approach recognizes that some misfit, or design deviation, may occur as a

functional response to multiple contingencies that the...work unit faces...Future research should examine the conditions under which control systems are complementary or substitutable⁶” (Fisher 1995, 41,43,45).

It has also been argued that corporate context may impact on management control systems (Merchant 1981). Because this research is examining the relationship between a marketing strategy and an accounting system, the relationship between accounting and marketing may be influential. “A multi-disciplinary study that considers management accounting practices jointly with practices in fields of...marketing” (Anderson and Lanen 1999, 409) has been called for and Fisher (1995, 45) states that “future research should also identify contingent factors that have not been examined.”

For this research, the aim is not to hypothesise contingent factors per se, in the first instance⁷. On the contrary the research aims to interpret an accounting system-strategy relationship in an organisational context: “[T]he accounting information system cannot be studied in isolation from its wider context” (Otley 1980, 426). Further, “different control arrangements may well be appropriate in organisations seeking...to optimise client service than in those which are seeking to maximise returns to shareholders...accounting systems are an important part of the fabric of organisational life...they need to be evaluated in their wider managerial, organisational and environmental context” (Otley 1980, 422). In that

⁶ For example, rather than rely on customer profitability information, a firm could substitute with customer revenue information only.

regard, many contingent factors may become evident. The research relies on existing research results for contingent factors described earlier in this chapter including the external environment, competitive⁸ strategy and mission, product life cycle, technology, unit, firm and industry variables⁹, knowledge and observability factors, economic and political upheavals and international outlook. However, the contextual approach should allow new factors to be discussed and identified.

As an example, Jassawalla and Sashittal (1999) note the emergence of cross-functional teams as popular structural solutions in relation to new product development. Johnson (1992) also discusses the importance of teamwork and how this has changed management accounting. For this research, an additional contingent factor may be the need for marketing and accounting functions to work cooperatively. The accounting department needs to champion customer profitability analysis or marketing needs to understand what information to request, which implies that collaboration between the two functions is essential. “Collaborative behaviours emerge when participants agree on a common agenda, openly share concerns and power, and commit to building trust” (Jassawalla and Sashittal 1999, 61).

⁷ As the research is exploratory, propositions will be derived from the qualitative evidence and the literature.

⁸ Sophistication and use of accounting systems was influenced by the intensity of, and type of competition faced – including price, marketing, and product (Khandwalla 1972)

⁹ Young and Selto (1991, 276) believe that issues such as “market dominance...combinations of market power (oligopoly) uncertainty, and product growth can lead to optimal, strategic costing systems”, yet these have not been examined.

Further, customer profitability analysis can be classed as an accounting innovation and there is relatively little evidence on the “diffusion of management accounting ideas” (Firth 1996, 632). Firth (1996, 630) states that for innovations to be adopted:

1. the perceived shortcomings that may be remedied with the innovation must be recognised;
2. there must be compatibility of the innovation with the organisations norms;
3. the organisation must be able to comprehend and implement the innovation;
4. is dependent on whether the innovation can be trialed;
5. is dependent on whether the perceived benefits of the implementation can be observed and measured;
6. a change agent or champion of a particular innovation must be present;
7. an organization must have sufficient existing labor skills to implement the innovation.

Other contingent factors that have been identified in the literature include the cost benefit trade-off: “management accounting practices are developed in conjunction with and evolve to fit the information needs of management, needs which are tempered by the relative costs and benefits of information and which are in response to both recurring and expected decisions” (Anderson and Lanen 1999, 380-381).

In addition to examining the relationship between strategy and cost systems, this research also seeks to establish if organisations were satisfied with the level of accounting information system support for the firm's operational marketing strategy. Otley (1980, 424) concurs with this approach: "In order to progress beyond the mere association of particular contingencies and accounting systems, a judgment has to be made about the impact of the accounting system in aiding organisational performance¹⁰" (Otley 1980, 424).

As Otley (1980) and Otley and Pollanen (2000) criticise contingency theory for using "hypothesised contingent factors for empirical testing", the approach taken here is two-fold. Firstly, four case studies were undertaken in four different industries. Interviewees were asked to describe their firm's strategies, in particular the customer retention strategy; they were asked if they have a customer profitability analysis system and if so to describe it. Finally they were asked their opinions on the relationship between customer retention and customer profitability analysis systems.

Four different industries were chosen to see whether the relationship is contingent on industry type. But in reference to contingent factors, interviewees were able to

¹⁰ "Otley (1980, 424) also notes that: "At an organisational level of analysis, different organisations may choose to act differently because they have their own preferences regarding the distribution and timing of benefits and the level of risk they are willing to accept. At an individual or group level of analysis an AIS [Accounting information system] may provide information that allows some groups to further their own purposes more adequately, but which is of little use to other groups. It is therefore important that in developing a contingency theory of accounting information systems the effect of the information on a number of dimensions of effectiveness is measured rather than an arbitrary choice of a single dimension or the issue be left implicit."

offer their views so that “an understanding of the manner in which variables interact in a specific setting” (Otley and Pollanen 2000, 13) could be achieved.

On the basis of these initial case studies, many contingent factors became evident. In the second stage of this research, these contingent factors formed the basis of the survey (see appendix three) used to test the contingency based theory developed (see chapter thirteen). This two-fold approach allows theory generation and testing – a complete research cycle.

Conclusion

This chapter has summarised the literature in relation to contingency research in management accounting. It shows that many contingent factors have been identified as affecting the relationship between strategy and management control system design. Yet as Fisher (1995, 48) states: “the weaknesses of current research suggests areas in which further inquiry would contribute to knowledge.” Because of the lack of academic research in the area of customer retention and customer profitability analysis, particularly in the management accounting literature, this thesis examines the importance and use of accounting information to support a customer retention strategy.

The next three chapters define customer retention, customer profitability analysis and the relationship between them, as this current chapter has set the scene for the need for this relationship to be examined using a contingent approach.

Chapter Three: Customer Retention

Introduction

“The goal of a customer loyalty¹¹-oriented firm is to gain, serve and keep loyal customers. These customers provide the revenue stability and cost advantage for sustainable competitive advantage and financial success” (Srinivasan 1996a, 31).

Johnson (1992, 1993) suggests that a customer retention plan is essential for achieving success. A customer retention plan is a business plan for maintaining and retaining a firm’s existing customers. Johnson (1992, 1993) believes that firms need to focus their attention on responsiveness to customer wants. The best way to do this is to “build long-term, mutually dependent relationships with customers” (Johnson, 1992, 73). In firms which possess such a focus, every action of the firm is directed towards the profitable attraction, satisfaction, and retention of customers (Johnson, 1992, 73).

As noted in chapter two, Langfield-Smith (1997) argues that the literature relating to operational strategy and management control system design and use is prescriptive, particularly in professional journals. In relation to marketing strategy it has been prescribed that firms should follow a customer retention strategy, yet there exists scant academic empirical evidence on the use of this

¹¹ The term loyalty refers to the customer being loyal to the firm. A customer who is loyal to a firm is therefore retained. As a result the terms are used interchangeably within this thesis, as they are in a significant portion of the literature.

strategy, nor the reliance of any management control system to support the strategy.

This chapter begins by defining what is meant by a customer retention plan and strategy¹². It identifies the key components of this strategy, which include employee retention, communication of company-wide commitment to the strategy and a range of customer retention techniques. The chapter then moves to a discussion of the importance of management information systems to support the successful implementation of the strategy.

What is a Customer Retention Plan and Strategy?

A customer retention plan is a business plan for maintaining and retaining a firm's existing customers. The plan can be formal or informal, but there are certain components that are regarded as fundamental. Firstly, customer retention plans should be incorporated into a firm's strategic plan (Stuchfield and Weber 1992, Reichheld 1994).

Secondly, an employee retention plan should complement the customer retention strategy (Sellers 1993, Drege 1991, Liswood 1991, Intindola 1991, Dawkins and

¹²Since starting this thesis the term Customer Relationship Management or Marketing (CRM) has become popular. Palmer (1995) believes that relationship marketing is a business strategy which aims to turn casual, discrete transactions between buyer and seller, into an ongoing relationship. Further, Gronroos (1994) believes that marketing should be concerned with the interactions between the customer and the supplier. However, at the heart of CRM is CR. If customers are not retained, a relationship cannot be developed with them. Customer Retention is the strategy which this research examines. CRM is not the focus of the qualitative work or the survey.

Reichheld 1990), as it has been suggested that retained staff get to know frequent customers and these relationships impact on customer retention and firm profitability (Reichheld 1993, Franklin 1997, Wilson-Ellis 1994).

To ensure that employee retention is successful in leading to customer retention, there must be extensive service quality training programs (Lian 1994) and employee performance and compensation should be aligned with the retention strategy (Post 1997, Reichheld 1993, Sellers 1993, Drege 1991, Liswood 1991).

Company-wide commitment to the retention strategy is essential and is achieved through the use of a corporate mission statement reinforcing customer retention. A visible corporate mission statement, with a theme of customer retention, will act as a reinforcement for employees of the organisation's commitment to customer retention (Johnson 1992, 75). This commitment must then be communicated to employees, customers, potential customers and shareholders. An efficient vehicle for this communication is the Chief Executive Officer's report published in the company's annual report. The benefits of using this medium are twofold:

1. It communicates to customers and potential customers the firm's commitment to customer retention;
2. The company's employees who read the annual report will see the Chief Executive Officer setting an example of customer commitment (Judd and Tims 1991, 355-356).

Commitment to customer retention must exist throughout the company. The process of establishing commitment involves:

1. Monitoring a customer's needs – collecting customer information in relation to spending patterns, product needs, and the changes in these elements, on a continual basis, through survey or focus groups;
2. Monitoring the needs-benefits gap that may arise – comparing customer requirements of products with those of your competitors products - again with the use of focus groups; and
3. Closing the needs-benefits gap – develop new products or market existing products to satisfy customer requirements that competitors may have been doing more effectively [i.e. the gap] (Goldshlager 1993, 15).¹³

Customer retention techniques are then applied to the customers to be retained.

These techniques include toll-free telephone numbers, call-backs, customer clubs, loyalty discounts, comment cards, cross selling of other products to retained customers, recognition letters in appreciation of custom, satisfaction guarantees and feedback from customers (Drege 1991, Lowenstein 1996).

Measuring and Ensuring the Success of a Customer Retention Strategy

Johnson (1992) believes that it is important to track potential causes of customer defection, such as competitors' actions or changing customer tastes and habits.

Tansimore (1997) argues that defection information should be used to prevent future defections. An information system that tracks customer data and

¹³ Lowenstein (1996) comments on the importance of a firm having knowledge of customer perception of employees performance. There may be a gap between the actual and perceived performance of staff by customers. Srinivasan (1996, 4) defines seven "essential I's" for ensuring customer loyalty (retention). These are: initiate contact, inform customers about initiatives, give customers incentives, make inferences from observations of customer behaviour, influence key decision makers, including staff and sales representatives, increase account share and immunise against competition.

determines profitability¹⁴ of certain customers or customer types should be used (Drege 1991). Lowenstein (1996) stresses the importance of an innovative information system for ensuring that retention is pro-active. The information collected on customers should then be applied to try and increase the number of customers companies retain. It has been argued that companies should not retain all customers, only profitable ones (Carroll 1991-1992, "Five Strategies..."1992, Peck 1997, Gronroos 1990). However, Aubrook (1997) believes that firms' retention strategies do not work effectively due to the inadequacy of their information systems.¹⁵

The firm's information system must be sufficiently sophisticated to provide retention measurement (Lowenstein 1996). Retention rates should be calculated for each line of business and these rates should be compared with those of previous periods and of competitors. Companies should set target retention rates and these targets should also be incorporated into the company's plans, budgets, and incentive compensation schemes (Dawkins and Reichheld 1990).

Two measures for calculating a company's customer retention rates exist:

1. The share of revenue from repeat sales to existing customers compared to new sales to first time customers; (Johnson 1992), and

¹⁴ To achieve this a customer profitability analysis system is essential. These systems are discussed in detail in the next chapter.

¹⁵ The issue of relevant information systems is addressed in subsequent chapters.

2. The share of each customer's requirements purchased from the company as opposed to its competitors. (Johnson 1992, Srinivasan 1996a).

Winslow and Capoor (1996, 25) note the importance of assessing the success of a customer retention strategy. They believe that "emerging winners have abandoned traditional performance measures such as...return on assets...in favor of a more comprehensive metric—lifetime customer net present value—that reflects their emphasis on customers as long term investments." Yet Wright (1995) found that senior executives are less than satisfied with current management information to support the retention strategy. The executives noted a predominance of financial measures in the reports and insufficient information regarding customers. Anandarajan and Christopher (1987) also found marketing personnel were dissatisfied with accounting measures, which lacked a focus toward the customer.

Conclusion

This chapter has described what is meant by a customer retention strategy and noted the importance of information systems to support the strategy, while also reflecting on apparent dissatisfaction with the quality of information available. It was shown that more recent literature advises that firms should not aim to retain all customers, only profitable ones. In order to determine the profitability of customers, firms need a management accounting information system, namely a customer profitability analysis system. The following chapter details the requirements of these systems and the role information from these systems may play in effectively supporting retention or other marketing strategies.

Chapter Four: Customer Profitability Analysis¹⁶

Introduction

“All customers are not created equal” (Schmid 1994, 144).

“You can’t afford to do business with some customers because of their bad loss potential, their unrealistic expectations of service, the [failure] to pay on time, or your inability to develop a relationship with them beyond price, where they’ll shop you every year.” (Mulcahy 1994, 14).

“Marketing is the art of attracting and keeping profitable customers” (Berger and Nasr 1998, 18).

“The increasing emphasis (in marketing) now given to profitable customers, rather than just sales, requires greater efforts to measure customer profitability than exists in most accounting systems” (Foster and Gupta 1994, 46-47).

As stated in chapters two and three this research seeks to examine the relationship between an operational strategy and the use of management accounting information to support the strategy. In chapter three it was shown that managers were dissatisfied with the information systems they had to support the retention strategy. Firms were requesting information on customers, in particular customer profitability and lifetime value of customers, but such information was not readily available. A customer profitability analysis is an accounting system which is

¹⁶ Information for this chapter draws on Arnold and Shanahan (1998). I am indebted to Susan Arnold for her effort in

capable of identifying the profitability of individual customers or customer groups (Foster and Gupta 1994a).¹⁷

This chapter describes customer profitability analysis systems. It begins by examining “first generation reports” (Foster and Gupta 1994a) and their limitations. This leads to the presentation of an alternative model, namely “second generation analysis” (Foster and Gupta 1994a). Second generation reports are more sophisticated and the reasons for this are explained.

Despite the development of customer profitability analysis systems to date, there remain fundamental problems relating to the determination of customer revenues and costs and these are discussed. One of the solutions recommended for increasing the accuracy of customer profitability analysis is the use of activity based costing in such systems. Although there has been limited literature relating these two types of costing systems, what is available is described.

Once a customer profitability analysis system has been developed, it can be used to support a firm’s strategy. How this information can be used in such a way is described. This discussion sets the scene for the research ideas developed later in this thesis.

helping me to consolidate some of the literature on customer profitability analysis presented in this chapter.

¹⁷ Some of these references date back to as early as 1989, however they remain relevant, for Guilding and McManus (2002, 45.) note that “there has been a growth in the number of accounting commentaries (although relatively few), that propose adopting customer and customer segments as units of accounting analysis.”

Customer Profitability Analysis Definition

A customer profitability analysis system provides management with information regarding the profitability of individual customers or customer groups. The calculation of customer profitability is straight forward - it is simply the difference between relationship (customer) revenues and costs, both adjusted for risk (Storbacka 1993, Rose 1991, Hartfeil 1996, Foster et al. 1996). Petty and Goodman (1996) believe revenue is “relatively simple” to measure. However there are enormous difficulties associated with determining individual costs, and these issues are discussed in detail later in this chapter.

Companies are enabled through such a system (depending on its level of sophistication) to determine which customers are low volume/low margin, and the relationships with these customers can be changed or managed (Smith 1993) to increase the firm’s profitability. However, such systems vary in their level of sophistication.

First Generation Customer Profitability Analysis

Simply identifying the costs and revenues associated with doing business with customers (Bellis-Jones 1989, Van der Velde 1990, Foster and Gupta 1994a, Booth 1994) is described by Foster and Gupta (1994a), as “first generation customer profitability analysis.”

Typically in first generation customer profitability analysis systems, costs are not broken down into customer-specific, general or corporate costs, and the variability

of customer-specific costs is not realised (Foster and Gupta 1994a). Petty and Goodman (1996, 55) believe that “businesses either have failed to measure or attribute costs to specific customers or they have not had the appropriate information to perform the calculation.” Firms that use first generation analysis typically find that a small percentage of customers contribute a large percentage of the firm’s profits, and that up to 70% of customers are unprofitable (Foster & Gupta 1994a).

The problem with first generation analysis is that it is relatively unsophisticated. The reports do not consider the future profit-making potential that currently unprofitable customers may have, as information focuses on current short term profitability only. Copulsky and Wolf (1990) state that the costs and revenues of a customer must be considered based on their long-term value, but traditional budgeting systems focus on short term periods.

Shapiro et al. (1987, 106) lament the inadequacy of customer cost accounting systems: “Companies with poor cost accounting systems have no way to determine order, customer, product or market segment profitability ... It’s management by anecdote”. Dwyer (1997, 9) believes that: “Despite great progress in cost accounting and database technology, some facets of commitment to the customer (with reference to a customer retention strategy) are maintained by myths and corporate culture more than ledgers.” Despite Shapiro et al (1987) scepticism, they do state that “even a system that estimates such costs only approximately can help a great deal.” Foster and Gupta (1994a, 4) are less

optimistic: “First generation customer profitability reports should be treated skeptically by management.” Reichheld (1996, 64-65) also criticises firms for relying on first generation analysis. For the information from customer profitability analysis systems to be useful to management, the weaknesses of first generation analysis must be overcome.

Second Generation Customer Profitability Analysis

Foster & Gupta (1994a, 2) believe that “high quality information cannot be developed from low quality data inputs.” Second generation analysis attempts to improve the quality of data input, recognising the long-term nature of the customer relationship by incorporating the “lifetime” value of customers (Bellis-Jones 1989, Storbacka 1993, Foster & Gupta 1994a, Berry & Britney 1996). The analysis incorporates all the costs and revenues that will occur during the entire life of the relationship (Foster & Gupta 1994a). These reports send management the “right signal” by directing attention toward the concept of customer retention (lifetime value of customers) and the long-term nature of customer costs, customer revenues and customer profitability.

Second generation analysis covers three major areas that first generation analysis fails to address. Firstly, its relationship approach allows appropriate identification of lifetime revenues and costs. “[It] extends customer profitability analysis to incorporate a cradle to grave (womb to tomb) focus on each customer.” (Foster and Gupta 1994a, 4). Customers reported as unprofitable in a first generation analysis may be identified as profitable over the lifetime of the relationship

(Foster & Gupta 1994a). This may be as a result of higher costs occurring at the beginning of the relationship and higher revenues accumulating as the relationship develops. Second generation customer profitability analysis is deemed to follow a relationship approach to analysing customer profitability because it recognises that customer transactions are ongoing and not discrete (Storbacka 1993, Foster & Gupta 1994a). Aubrook (1997, 19) argues that “today’s customers expect to be treated on the basis of their total relationship with an organisation.”

Reichheld (1996, 64-65) suggests that companies compete for profitable customers, and efforts to determine customer profitability should consider the “loyalty coefficient.” This coefficient would reflect the lifetime value of the customer. However, he states that the practice is not common, except in the life insurance and credit card industries. Other authors have been more positive. Dwyer (1997) provides a description of a customer lifetime valuation model for the direct marketing industry and Gloy et al. (1997) provide a similar definition for the agricultural industry. Also Bitran and Mondschein (1997) explain how a customer life time value model can be used in the catalog sales industry. Finally, Berger and Nasr (1998) provide a series of discounted cash flow mathematical models for determining customer lifetime value.

The second improvement that second generation customer profitability analysis provides is the identification of cost variability differences. Some costs may be short term variable costs (for example, account set-up costs), whilst others are long term variable costs (for example, on-going administration costs). Changes in

customer numbers and/or customer service levels can also affect customer profitability over time (Foster & Gupta 1994a). These changes are more easily identified, and hence more correctly matched with revenues, in a second generation report. This cost differentiation allows managers to examine the relationship between customers and their short term costs and assess whether they are profitable. If they are not profitable, management can determine ways of restructuring the long-term cost structure in an attempt to make the relationship profitable in the long run: “the challenge is to restructure the relationship so that over the long-run there is a better relationship between revenues and long-run costs” (Foster and Gupta 1994a, 5).

Lastly, second generation analysis categorises cost hierarchies (Foster & Gupta 1994a, Petty and Goodman 1996), which differentiate costs into cost pools to which relevant drivers are attached. Costs can be allocated into the following cost pools: customer specific costs, general customer costs and general corporate costs (Foster & Gupta 1994a, 3). An example of a general customer cost would be a television campaign, because this cost would benefit all customers (retained and potential, profitable or unprofitable). Yet a telephone salesperson answering a specific call to a client would be an example of a customer specific cost. Foster & Gupta (1994a) note that the three pronged analysis obviates the need to allocate general corporate costs to a specific customer.

Using an alternative hierarchy, Petty and Goodman (1996, 56) break down customer costs into order level - the process of receiving purchase orders;

customer level - non-order related costs of obtaining and maintaining a customer, and market segment level costs - activities required to ensure a place in the market.

Second generation analysis includes “lifetime analysis”. The term is somewhat ambiguous. It is impossible to accurately determine the “lifetime” of a customer relationship. Instead, Storbacka (1993) believes that a firm should choose the time horizon most appropriate to that industry. Furthermore, the time horizon should be a “rolling” horizon. Storbacka (1993), in a study of the Swedish banking industry, believed a one year time horizon to be appropriate for that industry.

In order to implement lifetime analysis of costs and revenues, as advocated by several authors (Storbacka 1993, Foster & Gupta 1994a, Foster et al. 1996, Hartfeil 1996), it is necessary for the firm to determine what drives profitability, and to define all customer revenues and costs.

Difficulties in Calculating Second Generation Customer Profitability Analysis

Shapiro et al. (1987) note that there is a great deal of difficulty in developing a customer profitability analysis system. Foster et al. (1996) identify the major “challenges” to producing accurate and reliable customer profitability information:

1. Developing reliable revenue figures which is complicated by:

- a) customers purchasing through different distribution channels or geographic regions and accounting systems not being designed to collect information across regions;
 - b) different levels of decentralisation of purchasing, (for example, if Ford purchases centrally then it is treated as one customer, but if Ford USA and Ford Canada make their own purchasing decisions, then these two are treated as separate customers);
 - c) multiple names and codes - the result of an 'untidy' customer data base;
 - d) different credit and payment patterns; and
 - e) revenue recognition issues - when is a sale a sale?
2. Developing reliable cost figures is hindered because:
- a) data is not collected by customer;
 - b) there is a lack of source records;
 - c) data is needed for the entire value chain;
 - d) many costs are not specific to individual customers and hence must be allocated, rather than directly traced.
3. Recognising future downstream costs, in particular environmental and litigation costs.
4. Incorporating multi-period or lifetime analysis which requires that profitability of customers is traced and budgeted for extended periods of time.
5. Recognising different drivers of customer costs - activity based costing may be able to assist in this area.

Use of Activity Based Costing in Customer Profitability Analysis

[Activity based costing] started as an extension and revision of cost accounting systems... [and can now be] used to evaluate many aspects of the business, including the cost of providing services to customers, and customer profitability (Pearce 1997, 82).

Under activity based costing, products are treated as the cost object. Production and support activities are traced to products using appropriate drivers which reflect the cost of product, including indirect costs and overhead. These principles

can easily be transferred to customer profitability analysis. Petty and Goodman (1996) believe that “activity-based costing has provided a new conduit and methodology for conducting a customer profitability analysis at a customer level which adds real value to the business.” Customers become the cost object and service activities are traced to the customer using relevant drivers which reflect the cost of those customers. Petty and Goodman (1996, 55) state that: “A customer profitability analysis using activity-based costing will highlight the customers and markets that make money or fail to make money for your organisation.”

Smith and Dikolli (1995) note that there has been scant attention paid to the use of activity based costing within customer profitability analysis systems. However Stuchfield and Weber (1992, 54) do provide a comprehensive example: “The London-based securities house, BZW developed BEATRICE, an innovative information system that combines activity-based accounting principles and a model of customer profitability to make an income assignment to each of the 6,000 trades the firm makes in a day”.

Smith and Dikolli (1995) argue that activity based accounting is particularly appropriate for the category of customer specific costs, as it is likely that activity analysis would increase the accuracy of tracing. As an example, “the average length of time spent taking a customer’s order might be measured and then applied as a weighting factor to the number of telephone calls made” (Smith and Dikolli 1995, 3). Similar analysis could be applied to distribution, debt handling,

inventory-support, holding requirements and other customer specific costs (Smith and Dikolli 1995).

Pearce (1997, 82) believes that an activity based approach to “customer profitability analysis will help you understand the cost of providing services for customers. It will also help you estimate each of your customers’ contribution to your net profit by relating activity costs to activity levels for each customer.”

Having described customer profitability analysis systems, this chapter now examines how information from these systems can be used to support a firm’s marketing strategy in a number of ways, including cross-selling, customer segmentation and customer account engineering.

The Use of Customer Profitability Analysis Information to Support a Firm’s Strategy

Shapiro et al. (1987) believe that information from a customer profitability analysis system can help a firm focus its (marketing) strategy. Petty and Goodman (1996) argue that customer profitability information can be used by a firm to better manage its customers to improve profitability for the firm, and Anandarajan and Christopher (1987) found that marketing staff believed that customer profitability information would be useful for making marketing decisions. Yet Dwyer (1997) argues that, despite the development of customer lifetime valuation models (equivalent to second generation customer profitability analysis systems), few firms use such information to support their marketing decisions. However, there is evidence of its use in some firms.

Gloy et al. (1997) shows how firms in the agricultural industry could use customer profitability analysis information to support a range of marketing strategies. Kirby (1996, 13) makes a strong case for banks to establish customer programmes based on best customers, and a key part of the definition of a best customer must include customer-level profitability: "Profit is the key driver for determining best customers." Lebowitz (1996) reiterates this view, describing the development of a high value customer recognition programme of a mutual fund company using a model that identifies best customers, based on profitability and other behavioural traits. Winslow and Capoor (1996, 26) also believe it is essential that firms have a "fully functional customer profitability system."

There are many positive approaches for dealing with unprofitable customers, which include: price negotiation (Storbacka 1993, Booth 1994, Hudson 1994), cross selling (Petro 1990, Storbacka 1993, Morris 1994, Hartfeil 1996, Kirby 1996, McCormick et al. 1996) and segmentation (Petro 1990, McCormick et al. 1996, "Profiting..." 1996, Berry & Britney 1996).

McCormick et al. (1996) believe that the banking industry's traditional cross-selling efforts have been focused on unprofitable customers. Typically, cross selling is driven by price, and price sensitive customers take up the new products. The products themselves may be profitable, but the customers' use of them is not. These authors point to the necessity of considering customer profitability when cross selling.

Timewell (1994, 29) believes that: “better understanding of customers and customer profitability suggests that more segmentation will evolve.” Segmentation recognises that certain individuals respond to certain options in a similar way (Larson 1996). Furthermore, segmentation allows firms to identify groups of customers who exhibit similar characteristics, for example, high turnover customers who buy in small amounts, middle of the road customers or big buyers (Orr 1995).

Stuchfield and Weber (1992, 55) note that “customer profitability systems support more intelligent customer marketing and management decision making.” The ability of managers to recognise different cost categories and revenue, and hence profitability per customer type, allows the focusing of strategy.

An analysis can be made of both short and long term cost and revenue relationships for each customer segment. Customers can then be classified, in the long term, on their profitability to the business. This analysis facilitates the identification of winner, loser, potential and problem customer categories (Bellis-Jones 1989).

Shapiro et al. (1987) take a similar approach. They recommend that customers be categorised based on the relationship between the net price realised and the cost of providing the good or service purchased. As a result, customers can be placed in one of four categories, namely carriage trade - expensive to service but quite prepared to pay the price for that service; bargain basement customers who are very sensitive to price but care little for service; passive customers - cheap to

service and not unwilling to pay a high price; and aggressive customers, who demand high quality service and low prices. The authors recommend targeting the most profitable groups.

Stuchfield and Weber (1992, 71) identify four customer categories based on the current level of profitability and the potential for growth. The categories are: target - high potential for growth and good current profitability; convert - high potential for growth but inadequate current profitability; aggressively retain - good current profitability and low potential for growth, and drop or introduce alternative mechanisms - low potential for growth and inadequate current profitability.

Costanzo (1995) classifies customers in three broad categories, with suggestions on how each category should be managed. A firm should keep the highly profitable customers, improve the profitability of the slightly unprofitable group, and change the relationship of the clearly unprofitable group (Costanzo 1995).

Based on any of these forms of classification the firm can employ a number of tactics to more effectively target its retention strategy, which should lead to increased profitability of the firm.

Although Hartfeil (1996) argues that the end result of a customer profitability analysis system is information which can be used to implement a firm's marketing strategy, he cautions that it is important to get it right when it comes to customers. "Decisions can be made to change the characteristics of a customer from

profitable to unprofitable but the success of such decisions depends on the accuracy of the information provided in the customer profitability analysis” (Smith and Dikolli 1995, 4). Pearce (1997, 84) adds that, if we find a customer to be unprofitable, “Do we fire that customer...Absolutely not!” Firing a customer should be the last resort because it may lead to idle capacity. Stuchfield and Weber (1992, 69) agree: “In the short run, management decisions will not affect fixed costs...For example, dropping unprofitable customers will not lower the current period costs of equipment, facilities, and administration”. There may also be negative market feedback from dropping customers. One of the first steps a firm can take is to manage the customer relationship. Many authors believe that customer profitability information can be used to analyse, and hence manage, customer behaviour (Howell & Soucy 1990, Storbacka 1993, Booth 1994, Smith & Dikolli 1995, Hartfeil 1996, Jeffrey & Franco 1996, “Profiting...” 1996). If relationships currently appear unprofitable, then the firm can change the characteristics of the relationship to make it profitable. Pearce (1997, 82) notes that: “decisions supported by customer profitability analysis will relate to how a business chooses to interact with customers in the future, and how the business chooses to produce the services necessary to support those customers.” Stuchfield and Weber (1992, 70) support this view, arguing that clients which are currently not returning a profit should be “monitored for improvement.” Petty and Goodman (1996, 55) argue that managers should act on customer profitability analysis information to reduce non-value activities within the organisation, to improve the profitability of customers.

Bellis-Jones (1989) identifies techniques for taking action to improve customer profitability which include productivity improvement and account engineering. The simple message discussed in productivity improvement is “look in” before you blame. Before a firm should discuss with clients any form of transaction restructuring, it is important “that the company’s overall operations are as cost effective as possible.” (Bellis-Jones 1989, 28). Account engineering can then be undertaken.

The aim of the account engineering technique is to manage the customer relationship through modifying customer behaviour which affects internal cost structures (Bellis-Jones 1989, Pearce 1997). There can be price increases (Bellis-Jones 1989, Pearce 1997, Stuchfield and Weber 1992); increases in customer volume (Stuchfield and Weber 1992) or a combination of customer activity reduction, price increases and volume increases (Pearce 1997). Reduction in activities is likely to free up resources which can be used elsewhere or there can be capacity reduction (Stuchfield and Weber 1992).

There are additional processes that can be applied to improve customer profitability. Business process engineering (Hansen and Mowen, 2000) allows processes to be evaluated with the aim of gaining competitive advantage through doing things more efficiently, for example improvements in credit approval processes. Alternatively, brand new processes can be put in place to make customer transactions more efficient.

Activity analysis (Hansen and Mowen 2000) undertaken on individual customers and customer groups can also be used to identify activities which provide value to the customer, and those that do not.

Conclusion

This chapter has documented the literature relating to customer profitability analysis and has shown how information from this management accounting system can support marketing strategy.

When research is undertaken examining the relationship between strategy and management control systems, it is important to have a measure of success of the strategy. In relation to customer retention, the existing literature has focused on examining the success of the strategy in relationship to profitability, but in the following chapter it is shown that no research has sought to measure success of the strategy in relation to the management accounting information systems in place.

Thus chapter five provides a detailed description of the existing examinations of the success of customer retention, leading to a prescription that information from a customer profitability analysis system should be able to be used to examine the effectiveness of a retention strategy. For this research, effectiveness will be measured based on user satisfaction.

Chapter Five: Measuring the Success of Customer Retention

“Putting customer relationships ahead of making sales undoubtedly raises a company’s profitability..., although little empirical research exists yet to prove that claim unequivocally” (Johnson 1992, 73).

Introduction

In the last two chapters a customer retention strategy was defined, and the development of customer profitability analysis systems was traced. At the end of chapter four it was shown how information could be used from a customer profitability analysis system to support a firm’s marketing strategy.

Langfield-Smith (1997) states that there is a great opportunity to measure the success of the management control system-strategy interface, particularly in relation to operational strategy. Research to date, in making an assessment of the relative importance of customer retention as a strategy, has sought to relate the strategy to measures of firm performance, in particular profitability, rather than management accounting information systems to support the strategy. The evidence comes primarily from consultancy firms and where there has been academic study it has not examined the role of accounting information systems.

This chapter begins with a discussion of the largely professional evidence which prescribes the importance of following a customer retention strategy by depicting

its effect on profits. Due to the nature of the evidence, there is some skepticism and these views are presented. Following this, the academic literature is presented. These studies show some support for the relationship between customer retention and firm profitability, yet this analysis also identifies the gap in the literature which prompted this research.

The case is made for the need to examine the relationship between an operational marketing strategy, namely customer retention, and the management accounting information systems used to support the strategy, as management accounting system design ought to be driven by strategic intent.

Measuring the Success of Customer Retention: Professional Evidence

A range of professional reports have claimed that small increases in retention will lead to sizable improvements in the profitability of the firm in a range of industries (Reichheld and Kenny 1990, Van Gorder 1991, Dawkins and Reichheld 1990, Furlong 1993, Lazos 1998). The professional evidence of the relationship between retention and profitability is shown in Table 5.1.

Author	Industry	Retention Rate	Profitability
Vavra (1995)	Banking	Increase by 5%	Increase by 85%
Connellan (1994)	Software	Increase by 5%	Increase by 35%
Connellan (1994)	Industrial Distribution	Increase by 5%	Increase by 45%
Connellan (1994)	Insurance	Increase by 5%	Increase by 50%
Connellan (1994)	Advertising	Increase by 5%	Increase by 95%
Mulcahy (1994)	Insurance	Increase by 5%	Increase by 25.2%

Table 5.1 Measuring the Success of Customer Retention: Professional Evidence

Foster et al. (1996, 17) comment that: “various rules of thumb have been proposed for retaining customers - for example, that it costs five times more to acquire a new customer than it does to keep an existing customer [but] such rules of thumb are rarely based on systematic analysis”. Further, Lash (1989, 4, 6-7) discusses many issues which influence this relationship including economic factors and reporting issues such as the difficulty associated with determining customer profitability and retention rates. Also there are apparent anomalies, such as industries that offer poor customer service yet retain customers and are profitable or, alternatively, unprofitable businesses which retain customers and offer good customer service. In the case of monopolies customers have no choice, so all customers are retained, regardless of service.

To date there have been “no definitive empirical data to support an absolute link between customer service (retention) and profitability” (Lash 1989, 8). The lack of empirical data may be due to the difficulty of quantifying such a relationship. Ittner and Larcker (1996, 2) comment: “the traditional customer satisfaction

survey methodologies used by most companies suffer from a number of limitations that make it difficult, if not impossible, to directly link increases in these indices to increases in financial performance”¹⁸. The authors surveyed 27 vice-presidents of quality and asked them to rank on a 6 point Likert scale their level of agreement or disagreement with statements, three of which related to customer issues. These statements were:

1. It is easy to directly relate your customer satisfaction (or customer loyalty) measure to revenue or market share.
2. It is easy to directly relate your customer satisfaction (or customer loyalty) measure to accounting returns.
3. It is easy to directly relate your customer satisfaction (or customer loyalty) measure to stock price returns (Ittner and Larcker 1996, 6).

“Only...27 percent of respondents felt they could relate customer satisfaction measures to accounting or stock price returns...62 percent of the executives could relate customer satisfaction to changes in revenues and market share” (Ittner and Larcker 1996, 5).

Reichheld and Sasser (1990, 110) believe that: “the longer the customer remain[s] a customer the greater the profit that customer generate[s]...the long-term customers tend to buy more, have lower operating costs, and create additional revenue through referrals.” They examined several companies in the life

¹⁸ This paper was in reference to measuring the impact of quality initiatives on firm performance but it is applicable to this

insurance and credit card industries (through their consultancy firm, Bain & Co., Boston) and determined that an annual 5% reduction in customer defection rates would increase customer life-time profits from 35%-85% depending on the product.

Later, Jones and Sasser (1995, 90), in reference to the 1990 work, claim that: “increased customer loyalty is the **single** most important driver of long-term financial performance...research has validated these beliefs” (emphasis added). However, this research was heavily criticised: “Unfortunately, the argument is flawed and its prescriptions are dangerous” (Carroll, 1991-1992). The flaws include the assumption that costs are mostly fixed and that customer retention “causes” profitability rather than correlates with it. Further, if retention is the dominant driver of profitability, how can there be profitable industries where retention is low? Fay (1994) also disputes the relationship between customer retention and firm profitability, finding that customers that had been with the firms the longest were the least profitable. Lowenstein (1996) also believes that the relationship between satisfaction, loyalty and overall performance is tenuous.

Other measures of the success of customer retention have been provided by:

“current and recent best-sellers...for example, *In Search of Excellence* by Peters and Waterman (1982); *Service America*, by Karl Albrecht and Ron Zemke (1985)” (Lash 1989, 8).

research as the authors note that: “improvements in customer satisfaction and loyalty [are] potentially the greatest source of competitive advantage from quality improvement” (Ittner and Larcker 1996, 2).

Reichheld (1996) provides a recent contribution to this literature also. Both Johnson (1992) and Lash (1989) believe that the best studies measuring the success of customer retention have been undertaken by Technical Assistance Research Programs Incorporated¹⁹, but the results of this research are not publicly available.

Much of the above analysis has been based on evidence from consultancy firms,²⁰ rather than academic study. Johnson (1992, 73)²¹ states: “putting customer relationships ahead of making sales undoubtedly raises a company’s profitability...although little empirical research exists yet to prove that claim unequivocally.” Lash (1989, 6) adds: “at present, there are no concrete measurements proving that to be highly profitable, a company or organization must deliver superior customer service.” Although the work deals with customer service, it is made clear that: “the paramount reason for a company or organization to spend money or resources to handle complaints and inquiries is to get repeat business” (Lash 1989, 152). Ennew and Binks (1996, 219) also comment: “central to the idea of investment in the development of service quality and customer relationships is the belief that such investments will enhance loyalty, retention and profitability. Empirical evidence on the extent to which such links exist is still partial.” Further claims of a lack of research are provided

¹⁹ This is an American Government Organisation.

²⁰ A review of the references in the bibliography attests to this view. Many of the references are in trade magazines.

²¹ This quote is repeated as it is seen as very important.

by Srinivasan (1996a) and Reichheld (1996, 62): “Intuitively, all of us have always known that customer loyalty (retention) was a good thing...but few of us have grasped its direct link to profits.”

The lack of academic studies has lead to some authors questioning this proposed link. Reese (1996, 52) states: “in the arithmetic of modern business, a satisfied customer is a repeat customer, whose long-term patronage results in higher sales and more profit. Or so it would seem....a growing number of companies are discovering...that improved satisfaction scores don’t necessarily translate into increased profitability.” Filip (1994, 72) questions, “**If** retention rates drive profitability...” (emphasis added) and Anderson et al. (1994, 53) ask: “does higher customer satisfaction (and hence retention) lead to superior economic returns? Widespread acceptance of this relationship is evident in the growing **popular literature**...[in] consulting and marketing research firms” (emphasis added).

Measuring the Success of Customer Retention: Academic Evidence

Pelham (1997) conducted a sophisticated analysis which examines the relationship between market orientation and profitability of small firms. This research combined the “performance elements of new product success, relative quality, and customer retention into the construct firm effectiveness...” (Pelham 1997, 60) and showed that firm effectiveness was a “mediating variable in the relationship between market orientation (a customer and competitor focus) and

profitability” (comprising return on equity, gross profit margin, and return on investment). They also found a positive and significant relationship between firm effectiveness and market orientation. These results show support for the relationship between following a customer retention strategy (among other variables) and corporate profitability.

Ennew and Binks (1996) sought to add empirical evidence to the relationship between loyalty, retention and profitability, with evidence from the United Kingdom banking industry. The model provided some support for the hypothesis that genuine loyalty and retention is influenced by service quality and customer relationships.

Further, Barnes (1997) showed that not all customer relationships are equal. Through interviews with 400 retail bank customers, the research identified factors that would most likely lead to the right kind of relationship which would likely lead to customer retention and long-term profitability.

Selnes (1993) undertook research investigating the relationship between customer satisfaction, brand reputation and customer loyalty. The results highlighted the importance of brand reputation to such a link.

Page et al. (1996) developed a model to analyse the effect of customer defection (the opposite of customer retention) on firm performance. The model uses a graphical approach with six steps. Step one requires the determination of current customer contribution; a time series customer defection rate is calculated in step

two; in step three the expected value of new customers is estimated and how this value varies over a customer's lifetime is analysed; an assessment of the existing customer base is made in step four; in step five, several projections are made of the future total contribution of the firm's customer base and, finally, marketing mix strategies are tailored to reflect the appropriate balance between new and retained customers in step six.

The model is then illustrated using data from an equipment lease company in a mature and competitive market. The researchers predict that: "focusing on retention marketing may prove to be more profitable than expending resources on new customer acquisition" (Page et al. 1996, 832). This research is useful in providing a graphical approach to predicting the effect of retention on profitability, but the researchers state that the case results may not be applicable to other organisations and they offer researchers the opportunity to undertake further analyses in other firms. Also the research does not show that a relationship between retention and profitability does exist, it is trying to predict whether it may exist.

Shanahan and Sowden (1995) undertook a pilot study which attempted to investigate the relationship between customer retention and profitability. A survey was sent to the top 40 New Zealand Companies. Companies were requested, among other issues, to state whether the firm had a customer retention plan and how long customer retention planning had been occurring. Further, survey recipients were asked whether the accounting system allowed profitability

by customer type (retained or new) to be determined, and what percentage of profitability came from retained customers and new customers. The profitability of these organisations, taken from the annual reports, was then compared with this information, using regression analysis. The overall results suggested no relationship between retention and profitability.

As can be seen from the above descriptions, there exist no studies examining the relationship between customer retention and the importance and use of management accounting information.

Customer Retention and Customer Profitability Analysis: Measuring Success

Stuchfield and Weber (1992, 74) believe that information from a customer profitability analysis system could be used to examine the effect of managing individual relationships on firm performance²². Describing a customer profitability analysis system employed at a securities firm, they argue that “the business value of the (customer profitability analysis) system may eventually be reflected in superior financial performance relative to consolidated industry figures...the ability to manage profitability at the level of individual relationships could result in improved performance of the firm overall...however such an analysis requires...data...[that] is currently unavailable.”

²² Performance was to be measured based on superior financial performance, relative to consolidated industry figures published by the London Stock Exchange, on a quarterly basis.

Foster and Gupta (1994) argue for the need to examine the relationship between customer retention and firm performance based on an individual customer basis. They refer to work by Anderson and Fornell (1993): “Marketing literature provides tests of [the] linkage between customer satisfaction and profitability...however the **primary focus** of this research is on the aggregate profits across customers rather than the profitability of individual customers” (Foster and Gupta 1994, 58, emphasis added). This research was subsequently published (Anderson et al. 1994). The research did show a relationship between customer satisfaction (which is believed to have a positive effect on customer retention) and long run economic return, for Swedish companies. But as stated above the work focused on global measures of corporate performance, including indicators of customer satisfaction drawn from the Swedish Customer Satisfaction Barometer, and economic performance measures, including market share and return on investment, and did not focus on any management accounting information used.

Gloy et al. (1997) have considered the importance of customer lifetime valuation to a customer retention strategy in the agricultural industry. A customer lifetime valuation represents a net present value calculation which considers all the costs and revenues that a customer is expected to generate over the firm’s planning

period. The amount is then discounted to current dollars (Gloy et al. 1997, 336)²³. Their thesis is that: “As customers evolve over time, firms which have developed long term relationships with the ‘right’ customers will have a definite advantage over competition” (Gloy et al. 1997, 336). “Right” customers are defined based on both present and potential profitability. The paper was concerned with developing the contribution margin of customer segments in the rural retail petroleum industry and then seeing how the information could be used for marketing decisions, which included the evaluation of promotional outlays, new customer investment, special offers, and for examining changes in customer behaviour. Gloy et al. (1997, 343) make a case for the use of customer lifetime valuation information for evaluating customer retention. They state: “by comparing the expected lifetime values under alternative customer retention rates, one can directly estimate the amount that could be profitably spent to increase customer retention.” The research does not consider the effect of customer retention on firm profitability²⁴. The researchers state: “a method to estimate the effects of customer retention on sales, costs and gross margins²⁵ through time would be of interest” (Gloy et al. 1997, 346), yet the research is normative rather

²³ Such a definition is very similar to what Foster and Gupta (1994a) term second generation profitability analysis, although in their definition there was no explicit reference to a net present value calculation.

²⁴ This idea of considering the long term nature of the interaction between the retention of profitable customers and long run firm performance was also suggested by Stuchfield and Weber (1992) and is discussed previously in this chapter.

²⁵ Although Gloy et al. (1997) do not directly refer to profitability, if “sales less costs” is examined for all customers in the customer base, then one is examining customer profitability.

than an empirical investigation of the outcome or use of customer profitability analysis to support a retention strategy.

Timewell (1994) and Costanzo (1995) show that in the banking industry between 40-60% of customer relationships were losing money, and as a result, there have been numerous calls for banks to “focus more on profitable and potentially profitable [accounts]” (“What...” 1995, 9). Morrall (1994, 65) argues for the importance of customer profitability information to the implementation of a retention strategy: “part of any retention strategy should be to find out why some customers are at the bottom of the profitability pyramid and why others are at the top.” Chemical Bank found that 20% of its clients provided more than 100% of its profits, while the remaining 80% lost some of those profits in varying degrees (Costanzo 1995). Lazos (1998, 67) states that: “ultimately the winners will be those who develop insight into their **customers’ profitability and attrition**, and then act upon it” (emphasis added). This comment is noting the importance of firms acting on customer profitability information to ensure proactive and effective, rather than “reactive”, customer retention.

Morrall (1994, 64) agrees: “segmenting a portfolio by profitability ... helps make more efficient use of marketing dollars because different segments respond to different strategies. For instance, retention should be the number one priority for Type A [customers which generate 80% of profits].” Chemical Bank also focuses its marketing strategy on its most profitable customer groups as evidenced by information from its customer profitability analysis system (Costanzo 1995).

Filip (1994, 72) too believes that a firm must focus its retention strategy on the most profitable customers and Ellis (1995) claims that thriving organisations focus on profitability by providing customers with service.

Many consultancy firms are advocating this position, moving away from the focus on retaining customers per se to retaining the profitable groups and tailoring marketing strategies to those groups. For example, Elliot et al. (1996, 4) believe banks must market to the “most desirable, profitable customers.” Firms are also encouraged to reassess the customer groupings on a periodic basis. It is likely that customers will switch categories (Post 1997). Carroll (1991-1992, 20) recommends extreme caution to firms blindly following a retention strategy. He makes it quite clear that a retention strategy must be based on an information system that can measure the profitability of individual customer relationships. He states: “any customer retention effort that makes the assumption that all customers are equally profitable, or even that all customers are profitable, will not be very productive and could be downright damaging.” Duboff (1992) also makes a plea for marketing personnel to analyse and manage a profitable customer.

Despite these calls for organisations to focus on profitable customers only, research shows that organisations lack such a focus, due in part to the lack of appropriate information systems. Bitran and Mondschein (1997, 109) comment that: “66% of direct marketers neither compute nor track customer lifetime

value²⁶.” A similar result was found in an earlier survey for the catalogue industry: Della Posta (1991) reports that only 22% of firms conducted analysis of customer lifetime value.

McCormick et al. (1996) believe that, in the banking industry, retention efforts are not focused on the 30% of customers who return 140% of total profits. The authors describe four levels of banks, based on a study of best practices in the industry. Level one firms focus retention activities where they will not improve profitability. At level two, the banks have information systems capable of determining customer revenue, cost and ultimately profitability. As the banks move through levels three and four, information from this system is harnessed to focus retention efforts on profitable customers and to seek new business from these pre-defined profitable customer groups. At this point the importance of the company's brand is recognised. McCormick et al. (1996) believe that too many banks are in the level one category, and that marketing efforts (in particular retention efforts) are only fully realised if banks move to level four. Clearly, the importance of a customer profitability analysis system to successful customer retention is being prescribed in the literature.

Conclusion

The above chapter has shown that both professional and academic evidence measuring the success of customer retention is partial and although there has been

²⁶ In chapter four customer lifetime value was seen as equivalent to second generation customer profitability analysis.

a call to examine the success of the strategy in relation to management accounting information systems, this research has not been undertaken. A large volume of non-academic literature prescribes that firms following a customer retention strategy should use information from a customer profitability analysis system to support the strategy, yet there is no evidence of the importance or use of customer profitability information to customer retention.

Chapter Six: Research Objectives and Methods

Introduction

This chapter begins with an introduction to the research objectives, set in the context of the previous literature chapters.

Langfield-Smith (1997) argued that in management control system and strategy research both case based and empirical research are still required. Futher, Cooper and Emory (1995, 286) believe: “It is possible to combine the best characteristics of two or more alternatives into a mixed mode - personal interviews for extensive questioning and probing to establish constructs²⁷ to be tested on the wider population through the survey.” Stage one of this thesis used personal and electronic interviewing, and stage two used a survey to test the theory on a wider population.

In stage one of this research qualitative methods were used and in stage two, a survey was administered. A description of these methods and why they were used is provided in this chapter.

²⁷ Because this topic is in its infancy, constructs will not be developed. Rather propositions will be established and opinions will be sought.

Research Objectives

This research seeks to gain a contingent understanding of a firm's strategy and information system interface. It also seeks to measure the effectiveness of this fit. In chapters three and four, the literature relating to a customer retention strategy and customer profitability analysis were described. In chapter five it was prescribed that a customer profitability analysis system ought to be used by firms following a customer retention strategy. Yet in chapter two it was shown that often that which is prescribed does not occur in practice. The explanation for this deviation is often explained using a contingent approach. Based on the literature chapters the objectives of this research are to:

1. To identify company perceptions of the level of importance of a Customer Retention Strategy
2. To attain insights into CPA adoption rates
3. To identify some of the contingent factors that might affect CPA adoption rates
4. To gain some perspective on the extent to which marketing managers are satisfied with the management accounting support for the operational marketing strategies.

Research Methods

Stage One: The Qualitative Evidence

Ryan et al. (1992) note that case studies have become more widely used in the last decade to facilitate an understanding of management accounting practice. Johnson (1995, 18) made a plea for this type of research: "Management accountants should help organizations find new stories to describe their affairs...by working to create channels through which people inquire openly about purpose and methods." Johnson and Kaplan (1987) chastised academic management accounting research as being divorced from

actual practice, due largely to the research method used for investigation. “They claim that management accounting research and textbooks have concentrated on developing sophisticated models in simplified production settings that bear little relation to problems faced by practitioners...They urge researchers to focus on field-based research designed to bridge the gap between theory and practice” (Drury and Tayles 1995, 268). Drury (1997, 100) also states that: “In the early 1980’s a gap between the theory and practice of management accounting came to be recognized.”

In a follow up critique to his earlier work, Johnson (1992, 175-176) continues the criticism of academic research, arguing that it: “has no bearing on what business people must know to run a competitive and profitable organisation in a global economy.” He strongly advocates a field-based approach to management accounting and business research: “The most appropriate place to learn about business, and to research and develop theories about business is in places of business. ” (Johnson 1992, 189). Field based research requires that the researcher go into individual organisations and carry out case studies.

Otley and Berry (1994, 47) believe that case studies “provide a vehicle by which theories can be generated and modified in light of data. They are likely to be valuable where existing theories are inadequate or incomplete.” Finally, Otley (1980, 425) believes that the contingency approach suggests the use of case study research in a small number of organisations, allowing feedback and close involvement between the researcher and the researched.

The above factors motivated stage one of this thesis. Because there was scant existing literature on the strategy-cost system relationship under investigation, it was felt that an

analysis of a few different industry sites would allow the contingent theory to be developed further.²⁸

Ryan et al. (1992, 114-115) identify five types of case studies:

1. descriptive – describes techniques and procedures currently used in practice;
2. illustrative - illustrate new and possibly innovative practices developed by particular companies;
3. experimental – undertaken to examine the difficulties involved in implementing new proposals or accounting ideas;
4. exploratory - used to explore reasons for particular practices;
5. explanatory – explain the reasons for observed accounting practices.

Ryan et al. (1992, 115) note that: “the distinctions between these different types of case studies is not necessarily clear-cut.” With the exception of experimental case studies, all of the above types of case studies were used in this research.

The Sites

“The researcher should adopt an opportunistic approach to fieldwork in organizations. Fieldwork is permeated with the conflict between what is theoretically desirable on the one hand and what is practically possible on the other. It is desirable to ensure representativeness in the sample, uniformity of interview procedures, adequate data collection across the range of topics to be explored, and so on. But the members of the organizations block access to information, constrain the time allowed for interviews, lose questionnaires, go on holiday, and join other organizations in the middle of your unfinished study. In the conflict between the desirable and the possible, the possible always wins” (Buchanan et al. 1988, 53-54).

²⁸ It was then felt that to complete the research cycle from theory generation to testing would overcome potential criticisms of the sole reliance on one form of evidence collection.

The Bank

The bank was chosen for two reasons. Firstly, it was known that the site was in the research area and Ryan et al. (1992, 121) believe that although: “(t)he selection of the particular case for study is relatively unimportant...a case [must be] within the relevant area which will enable the researcher to begin the process of theory development”. This site was identified as being in the process of developing its customer profitability analysis system and was also following a customer retention strategy. Second, contact had been made with the bank during previous research and Buchanan et al. (1988, 56) state that, when getting in, “use friends or relatives wherever possible.” These reasons support the selection of the site, namely a major New Zealand bank.

The Bank²⁹ is the second largest financial institution in New Zealand. It has 5,124 full time equivalent staff (6,038 part time), has assets of \$21 billion and operates through 220 branches. It is owned by an off-shore parent company which employs approximately 46,500 full time equivalent staff (52,250 part time), and services over 9 million customers. It operates through 2,425 branches in several countries, namely, Australia, New Zealand, the United States of America, Scotland, England, Ireland, and Asia. Group assets are \$202 billion and the parent bank has a long term rating of AA by the rating agency, Standard & Poor’s. The group is listed on the Stock Exchanges of New Zealand, Australia, London, New York and Tokyo.

²⁹ All information for this paragraph is drawn from the 1997 annual report.

The Manufacturer

The Manufacturer was chosen for two reasons. Firstly, there was a prior contact through a friend (Buchanan et al. 1988), and secondly, the researcher wanted to cover a range of industries as industry had been shown to be a contingent factor in previous studies³⁰. The manufacturing site provided major differences to the results reported at the bank. The manufacturing firm is one of five subsidiaries of a major clothing manufacturer. In 1997 the company had turnover of \$51.7 million, operating assets of \$26.8 million and employed 559 employees.

The Energy Firm

The energy firm was chosen for similar reasons to the manufacturing firm. Firstly, the site provided an alternative industry. Secondly, after an initial discussion with a colleague it was believed that the firm was following a customer retention strategy and that it did have in place a customer profitability analysis system. Based on this discussion the researcher approached the organisation and it agreed to participate³¹. The site has again provided a wealth of different evidence from the previous two sites which

contributes extensively to the contingent analysis. The firm is one of the country's leading energy providers. It employs 920 staff and has 270,000 customers in more than eight centres around New Zealand. In 1998 it had turnover of \$507 million and group assets of \$983 million.

³⁰ See chapter five.

³¹ Buchanan et al. (1988) state they were less successful gaining access with cold calls but in this case a cold call was successful.

The Courier Firm

The fourth site is a courier firm. Once again the site was chosen because of a contact, and the desire to cover multiple industries. The courier firm is aiming to be the brand leader in New Zealand by the year 2000³². It experienced 22% increase in volume of business in the 1997 financial year and it employs 450 owner-drivers. The company has a network that operates throughout New Zealand.

Gaining Access

In the main, the same procedure was taken for all research sites. A letter was sent to the marketing manager explaining the research. As Buchanan et al. (1988) recommend, the letter emphasised that the information was to be used primarily for teaching materials for use in our courses, rather than it being necessary to complete this research or for academic publications. A copy of the letter is provided in appendix one. A follow up phone call was made a week later.

Finally, an email questionnaire was sent to the marketing manager and finance manager of each site. The researcher sought the opinion of both marketing and accounting because in chapter six it was discussed that the management accounting-marketing interface may impact on the strategy-cost system relationship. The respondents answered the questions and returned the responses via electronic mail. Whenever a response was not understood, an email response was once again elicited for clarification purposes.

³² This target has already been achieved as at October 1998.

However, for the Bank, the procedure was slightly different. A contact was made with the marketing manager of the Bank in March 1998. Previously, a graduate student³³ had visited the bank in 1997 to document the existing customer profitability analysis system and the problems that existed with that system³⁴. At this time, the company was “frustrated” with the system and was planning a refinement. A letter was sent to the marketing manager on the 23rd of June 1998 and as a result a visit to the bank’s head office was arranged in Wellington in September 1998. A personal interview was undertaken with the finance manager at the site. As a result of this interview, two additional individuals were identified as being able to provide input, namely the marketing manager and another member of the finance team who had “championed” the customer profitability analysis system. These interviews were undertaken using electronic mail.

Collecting the Evidence

When endeavouring to undertake case studies, one must get commitment from organisations to participate for a period of time, in order to undertake interviews in particular. As early as the 1980s, Buchanan et al. (1988) lament the difficulty of

³³ I wish to thank Susan Arnold for helping me to gain access to the site.

³⁴ This research resulted in a paper presented at the AAANZ conference in Adelaide, July 1998.

gaining access to firms for a number of reasons. Firstly, with the growing interest in organisational research, organisations get inundated with requests and secondly, employee time has become more valuable and there is little time to devote to academic research. Because of these issues the introductory letter did give interviewees the opportunity to answer the questions via electronic mail. Unexpectedly, email interviewing dominated the research process. In all four firms the marketing manager³⁵ was asked:

1. if the firm would participate in the study and
2. if they would prefer a personal meeting or if they would like to undertake the “interview” via email.

In all cases the correspondents, without hesitation, supported the email option. Comments made were: “*oh email definitely*”³⁶ and “*e-mail away!*”³⁷ The marketing manager was asked to advise the researcher of the management accountant’s name, and of course, the relevant email address. The researcher then telephoned the management accountant and asked the same two questions – would they participate in the study and would they prefer a personal interview or email correspondence. Once again, email was the unanimously preferred option.

As a result, e-mail questionnaires provided the major source of case study data and as stated earlier, were sent by the researcher to two individuals in each organisation, the marketing manager and the finance manager. A copy of both questionnaires is provided

³⁵ Because the research examining marketing and management accounting issues was being conducted by an accounting researcher, it was felt important that the marketing personnel be “brought on board” first. An initial telephone conversation was had with the marketing manager. In this communication, the researcher was introduced, as was the topic, and it was also communicated to the marketing manager that the management accountant in the firm would also need to be included in the study.

³⁶ The statements in italics refer to information received from interviewees, either by telephone or e-mail.

³⁷ The reasons for this option being favoured are presented later in this chapter.

in Appendix Two. The questionnaires contained unstructured and structured questions based on the literature presented in chapters three to five. The questionnaires were treated like an interview because responses were continually clarified, via continuing email “conversations,” which allowed interpretation. Respondents were very willing to keep corresponding, for example: *“I am very happy to interpret my answers further”*.

All correspondents were asked why they felt email to be the preferred option. The principal response was: *“That way I can get to it in my own time”³⁸*. Respondents also felt that they would be able to spend more time reflecting on the questions asked, rather than being rushed to provide an answer in the time that any personal appointment may have been scheduled for.

At the outset, it was envisaged that personal interviews would be undertaken because is believed that interviews provide a detail of information, not possible through a survey (Dane 1990). Further, the use of personal interviews involves surveyor-subject interaction which allows the provision of detailed explanations and examples to the interviewee (Abdel-khalik and Ajinka 1979, Cooper and Emory 1995). In addition interviews provide a flexibility which survey responses do not (Hanke et al 1984).

However, the principal disadvantages of personal interviews are their cost, in terms of time, for both the interviewer and the interviewee, and the existence of interviewer bias in interpreting responses (Cooper and Emory 1995). The way questions are asked, the order of questions, any explanations of the meaning of the question, and the way the

³⁸ Many of the e-mail correspondences were sent late in the evening, providing evidence of the questions being answered outside normal working hours.

interviewer interprets the respondent's answers can all reduce the validity of data gathered by interviews (Cooper and Emory 1995, Hanke et al 1984).

Further, in a personal interview situation, "noise" inherent in the communication process can be excessive. Theories of communication (see for example Mosley and Pietri 1975, 98-101) state that a message is sent from the sender to a receiver through a particular medium. The message is received and communication takes place when there is feedback from the receiver to the sender that the message has been received and understood. There can be "noise" inherent in the message due to the medium. Noise does not necessarily mean the audible kind, but can be any kind of interference between sender and receiver or receiver and sender. For example, interruptions or disturbances caused by other people, such as a person walking past the window; the interviewee really thinking about more pressing issues such as their own work or they are tired, or unwell. All such examples of noise can avert the attention of the interviewee.

Buchanan et al (1988) also state that there has been criticism of interviews because the closeness of the relationship between the interviewee and the interviewer may corrupt the evidence.

Finally, the use of a tape recorder to record interviews can influence respondents' answers (Richardson et al 1965).

This research shows that an email interview overcomes many of the disadvantages inherent in the personal interview process, while preserving many of the technique's advantages. Firstly, the use of an electronic medium helps to overcome the cost problem. Email is a cheap form of communication and one is able to interview many people, even those at a distance, and save, particularly on travel and accommodation

costs. Also, interviewees can answer the messages in their own time, rather than the researcher demanding office time to carry out the interview process and as stated above employee time has become more valuable (Buchanan et al 1988).

Interviewer bias in interpreting responses is also overcome in a number of ways using electronic mail interviews. Firstly, all of the discussion is written only once – by the interviewee. This information can be “cut and pasted” into a word processing document. Such a process reduces the possibility of interviewer bias. There is also an electronic record of all evidence which can be used by future researchers³⁹, quickly and easily.

“Noise” is reduced because the respondent can focus on the message in their own time, without the influence of the interviewer being present. The communication process can also be verified by feedback through the continuing discussion that can take place via future email correspondence.

Finally, the use of a tape recorder is not necessary when using email interviewing, thus respondent’s answers are not influenced by this procedure.⁴⁰

The advantages of personal interviews presented above are maintained using an email approach. Firstly, there is surveyor subject interaction. Although the interviewer and interviewee do not “physically meet,” ongoing conversation through an electronic medium is possible. Thus the “detailed explanations” (Dane 1990) necessary for

³⁹ See Chua (1988).

⁴⁰ In one case an individual stated that he felt very comfortable providing honest answers via e-mail as he believed that e-mail was safe and that others in the firm could not check his responses. He felt that checking would be more likely using other means of

interpretation can be communicated, and numerous examples can be provided. In addition, these communications can take place at any time, rather than at times of scheduled appointments. This allows the interview to continue for a considerably longer period of time, providing more opportunity for clarification, rather than less.

Further, interaction must, in a technological age, be interpreted in a number of ways. A comparison may be made to the opportunities available via internet chat lines, where people do interact and feel they get to know each other, even though they have never physically met. In some instances these people eventually do meet as a result of this ongoing correspondence and become lifetime companions.⁴¹ Clearly electronic interaction can and does occur.

However, it is important to consider the technique's disadvantages. During this research the major problems revolved around follow up. It was easy for interviewees to "*forget*" about answering messages, or messages were "*accidentally deleted*." Further, when sending an attachment file, in some cases the message could not be read at the other end, due to differing software. All of these problems are not difficult to solve. Researchers must be conscious of not overburdening participants with requests for information, but remain committed to continuing to undertake the conversations. Technical issues can also be easily overcome by re-sending messages, files, etc.

Although an email interview can reduce the influence of researcher bias, a new bias

communication. This level of comfortableness may be mis-guided as e-mail may in fact be less safe. It is possible to gain access to e-mail files. Also it may be that e-mail creates its own level of "self-consciousness" in other ways.

⁴¹ In the American media in particular, weddings of people who have met on the Internet, have become popularised.

may emerge. There is a loss of information resulting from not being able to read body language, etc. Tone and pitch can convey as much, if not more than actual words said. Also, as respondents have time to consider their responses, they may be edited, rather than off the cuff, and hence may be less truthful. In response to this though: Schlender (1995: 134) reports on an electronic interview with Bill Gates, stating: “To quiz Bill Gates...Brent Schlender E-mailed a set of questions via the Net. The answers came back sarcastic, incisive, compelling, and competitive-vintage Bill.”

Finally, an email interview does not overcome the disadvantages centred around the influence of the way questions are ordered or asked. Clearly when questions are sent, they are sent in a particular order so it is likely that this disadvantage will remain. The above disadvantages must be weighed up against the perceived advantages presented earlier.

The second source of information for the case studies was document analysis. The written sections of the annual reports of the respondent companies were examined to gain a sense of the firms’ commitment to customers (Judd and Tims 1991, 357)

Assessing the Evidence

Buchanan et al (1988, 53) state that it is important to have “adequate data collection across the range of topics to be explored.” Typically in case study research this involves conversation – interviews and document analysis. Ryan et al (1992) believe it is important to use multiple sources of evidence and assess the “contextual validity” of the evidence. Context can be assessed using different pieces of evidence about the same topic. This approach has been followed here with the use of email interviews and document analysis.

After the four case studies were analyzed several contingent factors appeared to be influencing the relationship between the firm's operational marketing strategy and its management accounting information systems. These contingent factors were described in chapter two. Additional opportunities⁴² arose to assess the existing evidence that had been collected. Firstly, when discussing my interpretations with a friend in the hotel industry, he suggested that the Chief Executive Officer (CEO) of a marketing agency would be interested in hearing my views. As a result, an interview was undertaken with the CEO to broadly discuss the issues which had ensued.

Based on this interview, the CEO recommended that I talk with one of his clients in the entertainment industry. This resulted in two personal interviews being undertaken with the CEO and the sales manager of the entertainment company.

Finally, another conversation with a friend of mine provided a contact in a primary industry firm, resulting in two email interviews being undertaken with the marketing manager and the financial controller of this large primary industry organisation.

The opportunities that these additional interviews create is two-fold. Firstly, the additional personal interview evidence does provide an assessment of the information received via e-mail interviews versus personal interviews. More importantly as two additional industries were utilised further evidence is provided on the contingent nature of the theoretical recommendations made in chapter fourteen regarding the industry variable. Finally, the interview with the CEO of the marketing agency provides an additional source of evidence with a global industry view. This additional evidence is

⁴² As Buchanan et al (1988, 53) believe, a "researcher should adopt an opportunistic approach to fieldwork in organisations".

not devoted to individual chapters but is brought in to provide additional explanation in chapter thirteen where applicable. A summary of all qualitative evidence collected for stage one of this research is provided in Table 7.1.

Firm	Personal Interviews	E-mail Interviews	Document Analysis
The Bank	Finance manager	Finance team Marketing Manager	1997 International Report 1997 New Zealand Annual Report
The Manufacturer	None	Finance Manager Marketing Manager	1997 Annual Report
The Energy Firm	None	Finance Manager Marketing Manager	1997 Annual Report
The Courier Firm		Finance Manager Marketing Manager	1998 Annual Report
The Marketing Firm	Chief Executive Officer		
The Entertainment Firm	Chief Executive Officer Sales Manager		
The Primary Industry Firm		Finance Manager Marketing Manager	

Table 6.1 Sources Of Evidence

Qualitative Evidence: Limitations

Laughlin (1995, 77) states: “(t)here are no comprehensive approaches to understanding the empirical world.” It is usually not possible to generalise case study research to a wider population, however this research uses the qualitative evidence to extend the theory (Ryan et al 1992), which is tested empirically in a second stage.

The research seeks to: “identify a pattern in the case[s]⁴³ and use theories to explain the observed relations. Where existing theories do not provide convincing explanations, then new theories may have to be developed or existing theories modified...Theories will be used to explain empirical observations, and empirical observations will be used to modify theory” (Ryan et al 1992, 120). The aim of the research is to examine, with some intellectual rigour, the ‘populist’ (and hence) normative and theoretical view, that following a customer retention strategy leads to firm profitability. In particular it seeks to gain an understanding of the role of customer profitability analysis in aiding that understanding.

Another criticism of qualitative research concerns the reliability of the evidence. Chua (1988, 73) states the importance of a quality control check to ensure that the data is trustworthy. One can use a range of techniques including explanation of data collection techniques and the preservation of data for reanalysis if necessary. Both of these approaches have been taken here.

Stage Two: The Survey

Drury (1997, 103) states that “surveys [of management accounting practice] provided a useful overview of current practice.” From the qualitative evidence described above a contingency based theory was developed of the operational marketing strategy-cost system fit. This theory is described in detail in chapter thirteen. In order to complete the theory generation–testing cycle a questionnaire was designed based on this theory

⁴³ It is inevitable for the material to be less in-depth, given four sites and the use of email questionnaires. My aim from the qualitative part of the thesis was to uncover any relevant emerging themes. This was achieved, particularly with the use of the additional qualitative evidence.

which sought to examine the level of support for five propositions developed from the qualitative material, on the use and importance of specific accounting techniques in relation to operational marketing strategy. The questionnaire was based on the findings presented in chapters seven through thirteen; the existing strategy/structure literature, and is presented in appendix three. The survey used closed structured questions in most cases (Cooper and Emory 1995, 299) and the responses relied on five point Likert scales (Cooper and Emory 1995, 179). As the research topic is in its infancy,⁴⁴ the survey sought information in the form of opinions, rather than measuring variables⁴⁵, as is typical of traditional contingency studies.

Sample Selection Method

The aim was to select two executives from each of 431 New Zealand companies, namely a senior accounting executive and a marketing executive. The reason for sending the survey to both of these individuals was to continue the approach of getting a firm view⁴⁶, as started in the qualitative part of this research. The acceptable job titles available on the data bases used were: for accounting: accountant, finance manager, financial controller, chief financial officer, administration manager, office manager; for marketing: marketing manager, sales manager, etc. Where no names could be found for

⁴⁴ See Guilding and McManus (2002)

⁴⁵ The exceptions are industry type and organisation size. These variables are used in the analysis as they have been in traditional studies.

⁴⁶ Although a firm view was sought, in the analysis presented in chapter fourteen, some analysis relies only on the marketing responses, as on reflection, it was felt that the user view was more appropriate than the firm view. Details are provided in that chapter.

a company's executives then the survey was sent to the financial controller and marketing manager⁴⁷.

Two databases were used to gather the companies' required details, namely Datex and the Universal Business Directory (UBD). Datex is a CD-ROM database of NZ companies which are listed on the NZ Stock Exchange. UBD is an Internet based database - www.ubd.co.nz. UBD contains all the organisations based in NZ and is equivalent to an organisational phone book listing with additional detailed information about each organisation.

The entire Datex database of 152 companies was used in the 431 company sample. However, some companies had to be eliminated as they were unsuitable. If a company had an overseas address or had been de-listed from the stock exchange, it was eliminated. After elimination there were 117 companies left which constitute all of the NZ Stock Exchange listed companies.

In addition to the sample selected from the Datex database a further 314 companies were randomly selected from the UBD database organisations that had ten or more employees. That is, the final sample contains 431 companies (117 from Datex and 314 from UBD).

As stated above, in keeping with the case study method, the survey was sent to the marketing manager and the finance manager⁴⁸. Where possible the survey was sent to a

⁴⁷ As Cooper and Emory (1995) state that a better response is generally achieved when a survey is sent to a named individual, all effort was made to find individual names. However, to maintain randomness in the sample, it was not possible to always use names.

⁴⁸ See footnote 42.

named individual and a response rate of 70% was received. Each survey had a covering letter and a stamped self-addressed envelope. Two follow-ups were made at three week intervals from the original mailing.

Cooper and Emory (1995, 282) state that the advantages of mail surveys are: they are cheaper; the respondent has time to collect the facts needed to respond; and, as anonymity is assured⁴⁹, the respondent may provide more honest answers.

Correspondingly surveys have distinct disadvantages. The first is that of non-response: “mail surveys with a return of about 30 percent are often considered satisfactory...”(Cooper and Emory 1995, 282). A response rate of 70% was received in this research. This is discussed in detail in chapter fourteen.

The second issue relates to the “the type and amount of information that can be secured this way” (Cooper and Emory 1995, 282) and the way questions are worded. In this case the questions were determined from the initial qualitative evidence and the survey was also approved by the thesis supervisors prior to distribution.

As Cooper and Emory (1995, 283) believe that “respondents should be able to answer the questionnaire in no more than 10 minutes”, this questionnaire satisfied this requirement, while still enabling all relevant information to be collected.

Cooper and Emory (1995, 283) also note that, to improve returns, that there should be follow-up methods used. Two follow-ups were used in this research and the detail is discussed in chapter fourteen.

Secondly, survey sponsorship is useful and in this case reference was made to the support of The Institute of Chartered Accountants of New Zealand, who did provide a scholarship for this thesis. Cooper and Emory (1995, 283) also state that return postage paid envelopes should be provided and this method was used. They also note the importance of personalisation. From the data bases used it was possible to use names in most cases. Where names were not available, the surveys were addressed to the marketing and finance managers. The surveys had a covering letter, which referred to the Institute's support. A copy of the first covering letter is shown in Appendix four and the second follow-up letter as Appendix five.

Layout was also considered and helpful advice for this was received from a thesis supervisor (Cooper and Emory 1995, 283-284).

Writing up the Report

Chapters seven through twelve provide the qualitative evidence. The report relies on "data [that] appear[s] in *words* rather than in numbers" (Miles and Huberman 1984, 21). The approach used for the analysis consists of a balance between description and analysis – interpenetration (Lofland and Lofland 1984). Descriptive text – through interviewee quotes and content analysis of the annual reports - is provided to identify either similarities to, or differences from the literature. The approach taken is to treat "interview accounts as compelling narratives" (Silverman 1993, 114). Answers to the unstructured questions given to the interviewees are presented to ensure that "enough evidence is provided to convince readers that the researcher has a good understanding of

⁴⁹ The surveys were numbered on the back so the surveys were not anonymous. It was necessary to code the surveys to know whether the response was a marketing or an accounting response.

the relevant circumstances (Ryan et al 1992, 124). However, “we do not need the full clutter of a transcript...Sanitization involves minor alterations to assist...representation (Buchanan et al 1988, 62). This approach allows a reader of this report to consider the conclusions drawn in chapter fifteen in context.. The quotes are followed with analysis by the researcher which provides an “interpenetration” (Lofland and Lofland 1984) balance and “explanation based on sound reasoning” (Ryan et al 1992, 124).

The results of the survey are presented in chapter sixteen. Multiple statistical tests were used and these are discussed in detail in that chapter.

Research Limitations

This research used a multiple case study approach in the first instance and a survey in the second. The use of multiple data collection techniques has helped to restrict many potential limitations of either method. The survey flowed from the case study research. The survey allowed the qualitative evidence to be tested. The theory development and testing cycle is completed.

Chapter Summary

This chapter has defined the research objectives, the methods used, namely qualitative evidence and a survey, and the corresponding strengths and weaknesses.

The thesis now turns to the evidence collected at the four sites. These findings are presented in the next four chapters, beginning with the evidence from the bank site. Cross site analysis is then undertaken in chapters eleven and twelve.

Chapter Seven: The Bank Findings

Introduction

In chapters seven through eleven, the evidence collected from the four principal sites is presented. The format of the chapters follows the literature in the order presented in chapters three through five, namely customer retention, customer profitability analysis and the relationship between customer retention and customer profitability analysis. The contingent analysis is reserved for chapter thirteen where it is used to explain the differences that occur between the four sites accompanied by the additional evidence. This chapter provides the evidence from the bank site.

The Customer Retention Strategy

The bank does adhere to a customer retention strategy, that is a strategy to maintain and retain the bank's customers.

Principally the customer retention strategy can be reflected at a customer segment level as well as a product level.⁵⁰

The bank focuses the strategy on its high value customer groupings:

[The customer retention strategy] feature[s] a lot stronger amongst high value customer groupings than lower value customer segments. Of the six key customer segments that the bank operates in there are active retention strategies in place for four of them.

⁵⁰ All quotes in italics are quotes from interviewees.

There is a “*high focus on retention*” for the “*premium, private, custom business and wholesale banking*” segments and a “*low focus on retention*” for the “*retail and packaged business*” customers.

At a product level there are many examples of retention mechanisms: for example, [one account] has a fee rebate system which rewards customers for the amount of business they have with us⁵¹.

Stuchfield and Weber (1992) and Reichheld (1994) believe that a customer retention plan should be incorporated into a firms strategic plan and this is the case at the bank:

Various customer retention plans are reflected in our strategic plan which is done once a year for three years ahead. There is extensive (formal) planning undertaken in key market segments.

Many authors believe that an employee retention plan is essential to a successful customer retention strategy (Sellers 1993, Reichheld 1993, Wilson-Ellis 1994) but at the bank there is a “*minimal*” focus on employee retention. However they do align compensation to retention (Post 1997):

...employees...tasked with managing the relationships with... customers are measured on portfolio retention.⁵²

...performance evaluation is being tied to the volume of business retained/generated;

and there are extensive service quality training programmes (Lian 1994):

A comprehensive Bank wide Sales and Service training programme was introduced in 1997 for virtually all bank staff.

There is training on service and sales aspects.

⁵¹ There are other loyalty based mechanisms which cannot be disclosed due to confidentiality issues.

⁵² The names of the accounts and people have been removed for confidentiality reasons.

Goldshlager (1993) notes that commitment to customer retention must exist throughout the company and that in order to achieve this three steps must be followed. Firstly, the company must monitor customer needs. At the bank this is achieved:

Principally through, staff feedback, market trends, overseas trends, ad hoc qualitative and quantitative research, customer feedback and research monitors.

Largely through feedback mechanisms from the business manager level. There is reporting of needs met and not met in the bank's information systems from the business managers' manager level. The business managers are then managed to meet certain targets set for the year.

Secondly, once the information has been collected the firm must monitor any need-benefit gaps which arise then thirdly, close that gap (Goldshlager 1993). The bank acts on the information in the following way:

Specific opportunities or threats are identified and projects raised through the strategic planning process. If the project is of sufficient merit then implementation will commence.

The bank uses the following customer retention techniques: toll free telephone numbers; call backs; customer feedback; customer clubs:

For example the Bank has a First Home Plan programme for customers who are saving to buy their first home. If they buy their first home with the Bank they receive special discounted interest rates;

loyalty discounts: for example, “*fee rebates and volume discounts etc.*,” comment cards; cross selling; recognition letters of appreciation of custom (Drege 1991). However, the bank does not provide satisfaction guarantees (Drege 1991).

Many authors note the need for sophisticated information systems to support a retention strategy (Aubrook 1997, Johnson 1992). At the bank:

...retention information [comes] from Market Research Monitors, for example, AGB McNair [private based research companies], management information system reports, for example, churn analysis⁵³ and post purchase surveys.

The bank runs management information systems and executive information systems to do this, largely run by our marketing area.

Information is collected on customer demographics, spending patterns, product needs and the changes in these elements.

Dawkins and Reichheld (1990) argue that customer retention rates should be calculated to measure the success or otherwise of a customer retention strategy, using share of revenue from repeat sales to existing customers compared to sales to first time customers and/or share of each customer's requirements purchased from the company as opposed to competitors (Johnson 1992). At the bank:

Primarily churn rates [are calculated], for example, for new product purchases vis-a-vis products lost and same at a customer level Churn rates are new customer gained versus existing customer loss. For example, if new customers gained is 10% per annum and existing customers lost is 7% per annum, then the net churn is 3%.

Target retention rates are set and compared with actual but not for the whole strategy:

We [set targets] on some products but not on all customers at a bank wide level.

The bank follows a customer retention strategy for a number of reasons. It lowers costs associated with long time customers; it reduces costs associated with replacing lost customers; the purchase of a wider line of company products by long time customers results in economies of scale and there is increased revenues from referrals (Reichheld and Sasser 1990). The bank commented that the:

⁵³ Described shortly.

primary reason [for following a customer retention strategy] is [for] attaining volume growth in key segments. If we can stop the leaks then we grow faster.

As discussed in chapter seven, a mechanism for investigating whether a firm is following a customer retention strategy is to examine the annual report to get a sense of the firm's commitment to customers (Judd and Tims 1991). This allows us to make an assessment of the evidence (Ryan et al 1992) regarding the bank's customer retention strategy. This evidence is collected from two sources: firstly the 1997 annual report of the International Holding Company, and secondly the 1997 report of the New Zealand Bank.

Document Analysis

International Report 1997

The firm's values are stated on page two of the report. The first value on this list of seven values is "service to our customers." In chapter four it was noted that service to customers was believed to lead to customer loyalty. Also Ittner and Larcker (1996) argued that quality initiatives should lead to customer loyalty; the second stated value of the bank is "quality in everything we do."

The fifth value is "growth and development of our people" displaying a commitment to employees. However, interviewees did not believe there was a focus on employee retention:

Cost reductions have become so vital to remain competitive, an employee retention strategy would not meet cost-to-income targets.

Employee retention tends to only occur on an individual level – if you're the kind of person they want to keep then they'll look after you. (But there is no grand strategy).

The report also states the mission of the group: “to tailor financial services to help individuals, families, businesses and communities achieve their goals”. These references are to customer groups.

The chief executive officer’s report comprised five pages. Page three, in particular, is devoted almost in its entirety to the issues of customers. In the document the following references were made to customers. On page two: “a broad customer and product base” and an aim to: “...meet the more specific demands of customers in national and regional markets”. The above comments referred to the changing nature of the industry within which the group has to work.

On page three:

This [the tailoring of services concept] enables recognition of local customer preferences while, at the same time, gaining the benefits of core products and common infrastructure. The group’s strategy recognises the need to continually search for improved distribution methods in response to customer demand and the ongoing drive for improved cost efficiency. Examples of the Group’s market leadership in this regard during the past year, included the [Bank’s] direct banking service. A first for New Zealand, direct banking customers can access a broad range of bank services, via telephone, facsimile or mail. In New Zealand the launch of national on line for business customers was another example of a significant enhancement to existing services. It enables customers to conduct a broad range of financial activities such as account reporting, payroll processing and supplier payments on-line from their offices. Investment...will provide the group with secure on-line banking and bill payment capabilities for personal and small business customers...

While competition in all areas of banking in the financial services sector continues to intensify, the group believes there is nonetheless considerable potential to **gain additional business from existing customers** and to attract new business through the integration of services (emphasis added).

Page four discusses the group’s approach to its people:

A focus on People: The Group continued to focus on its people as a key to meeting its objectives...the roles of staff at all levels have in the achievement of group objectives. The group has launched a team-

based leadership model to encourage ownership, involvement and creative contribution from all staff.

In summary at least 25% of the report is devoted to the issue of customers and there is a positive statement about increasing business with existing customers and training and maintaining employees.

The New Zealand Report

On the first page of the report, there is a section listing seven highlights. One of these highlights relates directly to customers: “introduced comprehensive sales and service training programmes and began installing new computer software to transform front-line customer consultations.” There is also a highlight directly related to service for customers: “Competed vigorously on the strength of our position as a total products and services provider – everything you want under one roof⁵⁴.”

The managing director’s report is one page in length. In that report, the following references to customers are made:

...a powerful base from which we can offer customers a package of products that provides a total financial solution... . This focus on a total provider strength relies on an obsession with customer service.⁵⁵ Service is key to unlocking the potential of the total provider positioning. So much of this year has been devoted to engendering a culture that revolves around service and about giving our people the training and the tools to make it happen. **Building great customer relationships with great service remains the central challenge** (emphasis added).

With this kind of approach comes the concentration on **high value customers**⁵⁶... mean[ing] customers for whom we provide not just one, but a wide range, preferably all, of their needs. (emphasis added)

⁵⁴ Consistent with the International report, the New Zealand report commits to the seven corporate values – these were discussed in the international section.

⁵⁵ The relationship between service and loyalty/retention has been described earlier.

⁵⁶ The determination of high value customers is discussed shortly.

We are looking to make one or few product customers into total portfolio customers. Not by trying to force on them what they don't want but by identifying and meeting more of their needs.

In summary, the managing director's report is "devoted" to the issues of customers, in particular customer service and the identification of high value customers as ones who purchase all (or a wide range of) services from the bank. These statements, coupled with the comment regarding people and training, show corporate commitment to a customer retention strategy by The Bank and this view was also expressed by the interviewees. However, interviewees did not feel that the company followed an employee retention strategy. This issue was discussed previously and will be returned to later.

Customer Profitability Analysis

As described in chapter three, a customer profitability analysis system is a system which provides information regarding the profitability of individual customers or customer groups. At the bank, the new system was developed to replace an outdated customer profitability analysis system:

The major "rollout" of this system happened in May 1998, and has been in operation since. There was a previous profitability model which was outdated and this system superseded that model.

The development of the system was a joint exercise between head office finance and the business service unit managers. Business managers are primarily involved in customer liaison and management. They are the "front-line" point of contact for the bank's small and medium sized business customers. Business managers attempt to fulfil customers' needs with the bank's product range, whilst at the same time ensuring the conditions of the bank's credit policy are met. Business managers manage a number of customers,

called a portfolio. Part of their role is to ensure that their portfolio of customers is profitable.

The system was designed due to requests for customer profitability information by business unit managers. Head office finance staff did an exercise whereby we went round the various business units of the bank to talk about profitability. We had a chat to the business unit managers and asked them what information they needed about profitability. Out of the visits, came a request from managers, for a profit model which they wanted as soon as possible. It was agreed that the model would be produced jointly, because it required resources from finance (Head Office) staff and business financial service managers.

The prime movers behind this model are Finance and the business banking area of the bank. The main concern was to understand the whole picture of a particular customer group's business including lending, investment, cash management and transactional aspects with the bank – with the emphasis on use when pricing or renegotiating or tendering for business. The system is designed to form a basis for action⁵⁷ and not only [to be] a for your information system.

The aim was to try and build a model that met the manager's needs. Business managers are distributed around the country close to customers for face to face contact. The model is part of each branch's front end system. The branch has access to a range of software packages and the profit models sit in there.

Interviewees described the system as having two parts:

The system has two facets to it. [The first facet is] a read-only: this is what happened in the past twelve months' view and a second what-if scenario modeling view. This system was designed primarily for business managers and is delivered on a common platform that every business manager has access to. It shows a breakdown of profitability for a particular group of customers that the business manager is managing as a single inter-related unit – a customer group, in terms of pricing, volumes, margins and fees. Profitability is broken down into its component parts of volume, debit and credit margins, fees - by type of fee, and costs, split between direct and indirect cost, as well as a measure of return on equity.

⁵⁷ This action is discussed later.

The Bank's system shows some of the characteristics recognised in second generation systems.

Firstly, it incorporates cost hierarchies (Foster and Gupta 1994a).

Customer specific costs are rolled into a general category called direct costs and other overhead and corporate costs are called indirect costs. Costs are driven by the event that is happening, for example, a transaction loads a different quantum of cost from a loan origination event.

Costs are divided into direct and indirect. Direct cost is defined as any cost that you have to incur from dealing with the customer, for example, opening an account. Indirect costs are classed as costs you do have to incur, but they are not necessarily related to the customer. It is useful from the managers' point of view, to see the direct costs.

Secondly the system uses activity costs⁵⁸ and standard costs (Hartfeil 1996). The model uses standard costs for products and an adjustment can be made directly by managers to reflect the time they spend with customer groups. The model is sophisticated in that it incorporates activity based accounting principles (Smith and Dikolli 1995):

Products, for example term loans, housing loan and overdrafts are assigned in the model using a standard cost.

The system uses unit costs from the bank's activity based costing models.

Costs used in the profitability model are provided by our activity based costing models.

The model incorporates an adjustment factor that the business manager can use to adjust the average activity based cost unit costs to reflect actual customer management time for a particular customer group. The adjustment is done at the entire customer group level. The business managers do not perceive the time spent on a particular customer as being separate from the group, therefore the adjustments to costs are done at the entire group level. No pro-rating is done.

⁵⁸ Activity cost information is not being used to minimise activity costs. "This lies in the realm of cost management [which is being addressed elsewhere in the bank] and not pricing which is the main thrust of the profitability model." This multiple strategy-cost system alignment is discussed in further detail in chapter fifteen.

Because the model is using standard costs, it assumes an amount of time spent on a customer for a particular product. But not all customers are created equal.

[A manager] may spend a lot of time with Customer A, and very little time with customer B, and that can make the difference as to which customer is the most profitable. The standard cost does not allow for the fact that you, as a business manager, might spend a lot of time with a customer, so, built into the front of the model, there is a system whereby the manager can put in the amount of time they spent with a particular customer group and the calculation flows through and recalculates the cost. A net business manager adjustment is made to calculate customer group profitability.

Berry and Britney (1996) suggest the inclusion of transaction intensity in a customer profitability analysis model. The bank is doing this. For example, customers typically have the choice of cheque writing, electronic funds transfer, automatic tellers, and telephone transactions. All of these transactions can occur within the same account, yet the costs involved may vary. The bank is including this variation in the model:

The transactional business aspect of the profitability model caters for the differences in costs between different delivery channels. Transactional costs are driven by the intensity of the transactions undertaken by the customer group and not by the mere existence of an account.

Another example of the sophistication of the model is the inclusion of indirect and general corporate costs (Storbacka 1993, Dale 1991):

These costs are shown in the profitability model. There is a measure of contribution before and after such costs. The emphasis is on full cost recovery, tempered by market pricing and other external issues.

There is also a maintenance cost charged to customers:

Each account is charged with a maintenance cost which includes systems and information technology costs.

The model does not recognise the lifetime value of a customer outside the use of the twelve month rolling time horizon, which is recommended for the banking industry (Storbacka 1993):

There is no measure of the stage of a customer's life-cycle with the bank. We don't predict lifetime revenues and costs – only a view twelve months out into the future. This is adjustable by the business manager so that they can bring in real-world factors that a numerical system cannot cater for. This is largely where the business managers come into the picture in their own right but the model uses [a twelve month rolling time horizon for lifetime analysis].

The model calculates profitability over the last twelve months, which is rolled over every month and we forecast forward one year based on historical balances or averages. We are comfortable with the rules we use to forecast forward but real life is unpredictable.

As a result the model does not distinguish between short and long term costs:

No – the only distinction is between direct and indirect costs. The idea is not to provide excessive amounts of data for the manager's consideration – only sufficient to form a basis for informed action.

Variable and fixed origination costs are not allocated over the life of the product (Hartfeil 1996), but written off up-front. The manager is requested to consider such costs when pricing services to customers.

The difficulty lies in the fact that these origination costs are up-front costs and should be considered by the business manager when pricing. Mainly such costs are recovered by fees.

Hartfeil (1996) believes delinquency costs should be incorporated into the model but the bank does not undertake this incorporation:

The model has operational costs only built into it. There is no provision [for delinquency].

Exit barriers are not generally included in customer profitability models (Stuchfield and Weber 1992), although they can provide organisations with strategic advantage. The following comments reflect the difficulty of such inclusion:

Exit barriers are not factored into the model. One has to manage the art of the possible.

However, the model does allow managers to undertake what-if analysis:

There is a feature in the what-if modeling⁵⁹ aspects of the profit model that allows business managers to consider migration strategies within a particular customer group.

The revenue side of the model relies partly on averages and partly on actual figures (Hartfeil 1996). The model is estimating the volume of product margins and fees with sufficient accuracy for individual customer groups because:

It relies on averages that incorporate historical trends but it is adjustable directly by the business managers based on their knowledge of what their customers are doing or planning for.

Several authors note the importance of including risk in any customer profitability analysis (Rose 1991, Grafton 1996, Hartfeil 1996). The bank has factored risk into the model using a return-on-equity calculation, but it was clear that risk was the responsibility of the manager not the model:

Risk is not factored into the model directly. Part of the review of a customer asks for the return on equity calculation. This leads into the murky world of Economic Value Added and other measures. We had a look at those. At the customer level, the revenue stream from the customer is where the risk is – not the revenue stream to the bank. Bank capital is determined by Reserve Bank legislation. We have to have a certain level of capital for a given level of risk adjusted assets.

⁵⁹ CARE interviews (interviews held with customers to determine customer needs) are conducted by the business manager and this information is loaded by the business manager when modelling a scenario using the profitability model.

The act's interpretation of risk is different from the banks. The revenue stream from the customer may be low risk but the act still requires the capital. We did calculate return on equity for very big business customers and if they were below a certain threshold on return on equity, and you are looking to do a deal, then managers need to consider the threshold. We do not say – don't do the deal – rather consider it. So return on equity [a risk factor] has started to filter into the model. What has to be watched is that people do not get fixated on the return on equity number, it's just a number.

The model calculates customer profitability using the following process:

	Sum of Individual Customer Interest Margins (Debit and Credit)
+	Sum of Individual Customer Fees
-	Sum of Average Product Costs for each Individual Customer
+/-	Net effect of the Time Adjustment over each Individual Customer
=	Return on Group
÷	Capital
=	Return on Capital

Table 8.1 Customer Profitability Calculation

The model is capable of calculating customer contribution and the expected value of new customers (Page et al 1996). There is also constant assessment of the customer base (Page et al 1996): *“In the management information system and executive information systems in the marketing areas.*

The Use of Customer Profitability Analysis Information to Support the Marketing Strategy

Information from the customer profitability analysis system does not support the bank's marketing strategy directly:

The model does not support strategy. It is not that grand really. It does not support marketing – it is too low level. Marketing do look at customer profitability from a total bank level, but that is different, based on total footings - revenues.

The customer profitability analysis system is described as an operational tool:

Primary users of the profit model are the business managers in an operational sense - It is a tool to be used by business managers to manage their customers. It is not a tool for senior managers to manage their business managers.

Information from the model is used for price negotiation (Storbacka 1993, Booth 1994, Hudson 1994); cross selling (Petro 1990, Storbacka 1993, Morris 1994, Hartfeil 1996, Kirby 1996, McCormick et al 1996) and segmentation (Petro 1990, McCormick et al 1996, Anonymous 1996, Berry & Britney 1996) but it is not the sole source for this purpose. Segmentation at the strategic level is based on total footings or revenue.

Information from the customer profitability analysis system is used to manage the customer relationship, via productivity improvements inside the firm and account engineering – changing the way customers do business (Bellis-Jones 1989):

It allows a manager to manage a particular customer. Managers can watch over time whether a customer becomes profitable”- “ The model has identified some quite large customers who we thought were profitable but they were not – before the model we relied on gut feeling.

The Link Between Customer Retention and Firm Profitability

The bank does tailor marketing strategies to reflect the appropriate balance between new and retained customers:

In the past we have particularly focused on acquisition, however there has probably been a shift in thinking in the last year or two to more of a balanced perspective - the challenge is for us know to implement this balance effectively.

The banking literature calls for banks to focus their strategy on the most profitable customers (McCormick et al 1996). However, in the bank high value customers are determined by account balance only, not profitability, despite the customer profitability analysis system in place:

High value customers are principally determined by total footings [balances] with the Bank. For example, a personal banking customer who has more than say \$100,000 in debit and credit balances would be defined as a high value customer.

The way the model impacts on marketing strategy is that the high value customers become the focus of the marketing directives sent by head office to operational managers. The operational managers then manage these high value customers, through information from the customer profitability analysis to try and ensure that these customers are not only high value, but also profitable. High value is based on revenue, because of the difficulties of estimating profitability, particularly with regard to costs⁶⁰, as discussed in the previous section.

Ittner and Larcker (1996) found that managers believed it was difficult to equate marketing strategy with accounting profits. The interviewees at the bank concurred. They did not believe that it was possible to relate the following of a customer retention strategy directly to accounting profits, one stating strongly, “No, Not at all!” .

Further, interviewees found it difficult to describe the relationship between following a customer retention strategy and profitability of the firm. This challenges the widely held view of many consultants and academic researchers that customer retention leads to firm profitability:

Much overseas research suggests [that there is such a relationship] however many of our competitors spend a great deal of money on customer retention and consistently under perform profit wise. I don't know what their view of long run is - never?!

⁶⁰ The cost omissions include: lifetime analysis which affects the ability of the model to undertake a long and short term cost allocation; origination costs both fixed and variable; delinquency costs and exit barriers which are not factored into the model. Also the model is based at a divisional level and includes revenue from customers and customer costs which do “not add up” to total corporate costs.

As a general observation, our retention strategies are not as strong as our acquisition or profit driving strategies. We have consistently outperformed the market from a profit perspective but maybe this will catch up with us eventually. [Profit] has been increasing through the mid-1990's however it has leveled off in the last year or so (a 5% increase from 1996-1997 – and the strategy has not changed).

We don't necessarily know the relationship exists - indeed I believe profit wastage would occur [if you] overly focus on retention - your customers would love you but you'd be making no money - it's a balancing act!

Another interviewee believed that profitability was driven by a range of factors:

There is the belief that careful customer retention, acquisition and exits are necessary for long run profitability of the bank.

Berry and Britney (1996) believed that for banks there are a range of profitability drivers, including deposit balance, consistent fee income, efficient lending practices, targeted customer development focusing on relationship building, targeting prospects that are within the profitable relationship profile, aggressive retention of profitable customers, and sales and service delivery which meets predetermined profitability parameters, margins and fees. At the bank it was made clear that profitability is affected by all of the above:

You cannot afford to look at profitability only on one dimension⁶¹.

Many authors suggest that a customer profitability system may help in understanding the relationship between profitability and customer retention (Petty and Goodman 1996, Stuchfield and Weber 1992, Foster and Gupta 1994). However, the bank's customer profitability analysis system does not allow a breakdown of total firm profits

⁶¹ This point is followed up later on

into customer profits and hence cannot assist in an understanding of the profitability of the firm:

The model provides information on a subset of overall profitability - The model is not capable of aggregating up. We could give a list of all customers but it presents a different view of profitability because not all costs put against a customer are business unit costs. It presents a different view from profit reporting for the unit. It would have most of the income from customers and business unit costs. The two just do not add up - The profit model does not break down total bank profits. It provides a view of the profit contribution of a particular customer group [a bottom-up view].

However, one interviewee believed:

...if you are managing a customer it is useful to know whether they are profitable or not - ultimately if all your customers are not profitable you don't make any money for the bank because all bank transactions are customer related.

Chapter Summary⁶²

This chapter has presented the research findings for the first site, a major New Zealand retail bank. The bank follows a customer retention strategy. Both interviewee comments and the content analysis of the annual reports attest to this view. The retention strategy is consistent with the literature apart from the lack of an employee retention plan, and the partial approach to customer retention measurement. However, the firm also follows two other dominant strategies, namely acquisition (of new business) and profit improvement.

The bank has in place a customer profitability analysis system which displays many of

⁶² This summary will literally summarise the chapter's findings. Cross-site analysis is undertaken in chapters twelve through fourteen. This procedure will be followed in all the findings chapters.

the facets of a second generation system (Foster and Gupta 1994a). However, several factors are either missing or treated differently than suggested in the literature. The model does not distinguish between long and short term costs, because the model uses a twelve month time horizon. Origination costs are not written off over the life of the customer nor are delinquency costs included in the model (Hartfeil 1996). Exit barriers are not factored into the model (Stuchfield and Weber 1992) and risk is only partially dealt with through a return on equity calculation (Hartfeil 1996). An interviewee comment sums up the difficulties with conforming with the recommendations in the literature relating to second generation customer profitability analysis: *“One has to manage the art of the possible.”*

Despite the bank following a retention strategy, and having a customer profitability analysis system in place, the bank does not tailor the retention strategy to profitable customers. Rather the strategy is focused on high value customers and high value is determined by total balances with the bank. Operational managers then use the customer profitability analysis information at an operational level, not a strategic one, to manage the customer relationship to try and make that relationship profitable.

Interviewees did not believe that it was easy to relate customer retention and loyalty to accounting numbers. They were not convinced that following a retention strategy did lead to firm profitability, and finally the customer profitability analysis system did not provide information that helped the firm gain an understanding of this relationship.

Chapter Nine: The Manufacturing Company Findings

Introduction

In chapter eight the bank findings were presented. Chapter nine continues with the presentation of the manufacturing company findings. Once again the evidence is presented with analysis reserved for later chapters.

The Customer Retention Strategy

The manufacturing firm does not follow a “formal” customer retention strategy.

However there is a focus on the importance of keeping customers:

No, we do not follow a structured strategy. Only good customer service and management practices to ensure our customers stick with us.

Informally, we are aware of the importance of retaining customers because it is easier than getting new ones.

We have a close relationship with our customers. We share a large amount of our strategic plan with them.

Our retention strategy is our ability to grow the profitability and offer expert advice in our product categories. In this way our customers use us for their strategy information.

Our situation with customer retention is different from some other companies. The low value nature of our products means it is not really worth developing a relationship with consumers. If you class retailers as our customers then most of them do deal with us. They don't tend to switch from us to competitors, as may be the case with banks.

Despite the lack of a formal customer retention strategy, the firm identified the following key components of its informal approach to customer retention:

Quick response, strong brands, quality service and on time delivery.

As Goldshlager (1993) states customer needs must be monitored for a firm following a customer retention strategy. At this firm this is achieved through:

Regular meetings held with customers by sales representatives and senior management. The firm also conducted a major survey 12 months ago of customers' needs and how we rated compared to competitors in meeting those needs.

We assess our current customers against our service delivery.

The firm acts on the information to close any needs-benefits gaps (Goldshalger 1993) in the following way:

We build strategies into our marketing and business plans, which are in response to the information. This is then implemented. For example, we needed to improve delivery performance so we invested in a scan picking system for the warehouse. Acting on customers' needs is fundamental to our business and happens every day.

The firm uses the following customer retention techniques: toll free telephone numbers, call backs, comment cards – “*on some labels*”, cross selling, recognition letters of appreciation of custom – “*to key customers at Christmas*”, satisfaction guarantees – “*on all products*”, feedback for customers – “*of course*”, and customer clubs – “*for a certain sector of customers*”. However, loyalty discounts are related to volume:

We do not really use loyalty discounts. [These discounts are] more related to volume.

Aubrook (1997) argued for the importance of a sophisticated information system to support a retention-marketing strategy. At this firm, there is some evidence of a customer retention strategy as described above. However, there is not a strong use of information systems to support the retention elements:

Not really. We do market research surveys from time to time.

We do analyse these things [customer demographics, spending patterns, product needs and causes of customer defections] in terms of overall marketing strategy but not specifically for customer retention.

Dawkins and Reichheld (1990) argue for the calculation of customer retention rates. Despite the “informal” nature of this firm’s retention strategy, customer retention rates are calculated using external sources of information:

We collect a lot of information on our share of the market by customer compared to our competitors. For example, we purchase data for [one of our lines from outside].

Yet budgeted or target rates are not set, nor are they compared with actual rates.

The firm did not have a focus on employee retention (Sellers 1993, Reichheld 1993, Wilson-Ellis 1994) nor is compensation and performance evaluation tied to retention (1997). There is service quality training (Lian 1994) but it is not extensive:

We have conducted training in the past two years for the Sales Team and the Customer Service Team. It is not extensive though.

The firm follows, albeit informally, a customer retention strategy: “*retaining customers is a ‘given’ business practice*” - for a number of reasons: it lowers costs associated with long time customers; it reduces the cost associated with replacing lost customers; and the purchase of a wider line of company products by long time customers results in economies of scale. However, the firm does not follow such a strategy for the purpose of increased revenue from referrals (Reichheld and Sasser 1990).

Customer Profitability Analysis

Given the “informal” focus on customers the firm does not currently have a customer profitability analysis system. However, Bitran and Mondschein (1997) and Della Posta (1991) warn against firms following a strategy of retaining customers without having

customer profitability information to provide the correct focus. This firm focuses its retention efforts on its top 50 customers, determined by revenue only:

[We do] not yet [have a customer profitability analysis system]... We look at customers based only on sales revenue and, in some isolated cases, look at gross margin.

We report on our Top 50 customers by turnover and have strict trading terms in place. We have set bulk buying incentive discounts which are available based on turnover.

However, a “crude” form of customer profitability analysis is calculated for one section of customers and used for price negotiation and managing this particular relationship:

[We calculate customer profitability]⁶³ only for a few key customers which we are supplying at low margin to make sure we make profits from that piece of business.

There is also a recent move to use this limited form of customer profitability information to manage the customer relationship:

We have strong relationships with our major customers. We are beginning to work more closely with our larger customers on supply chain management to improve the profitability for our business categories, pre-pricing and increasing stock turns etc. Some retailers have very poor stock turn performance.

The firm does not use customer profitability information for cross-selling, or segmentation in a general sense.

The focus for profitability in this firm is on brands⁶⁴:

⁶³ In reality, the calculation is sales less cost of goods sold, a margin calculation rather than a profitability calculation.

⁶⁴ In chapter fifteen, the contingent analysis, a discussion of strategy-control system fit will be provided. This firm provides an example of this. As Bruggeman and Van der Stede (1993) state, knowledge of these relationships is limited.

We drive our marketing on a brand basis, that is, strong brands allow a price premium against generic brands. Thus, we look at brand profitability rather than customer profitability. We are very careful with where we want our brands to fit in to the market.

We also do an analysis of shelf space profitability, particularly in supermarkets. Shelf space allocation to our brands is based on profitability for the area we take up. We are continually analysing this against our competitors and other supermarket categories. For instance, our shelf space for [our product] in supermarkets will likely come under pressure when beer sales are available in supermarkets. Repackaging to reduce space and other areas need to be looked at.

Brands, rather than customers, also strongly influence price setting:

We set our prices based on a market analysis of brand positioning. We do not vary prices greatly between retailers other than seasonal promotions. When we bid on private label business we look at the profitability of that particular piece of business and any costs associated with gaining the business. We also have a different strategy for tendering offshore.

Content Analysis

The dominance of brands to this firm is evident when content analysis is undertaken of the annual report. In the 1997 annual report, there is a one page report on this subsidiary. It mentions the word “consumer” only once. The remainder of the page identifies six of the firm’s brands and discusses the marketing strategies related to those brands.

The chairman’s report (related to the entire company) is two pages long. It also makes no references to existing customers, but presents a section (one of six) on brand development, and also discusses staff in another of the sections. This analysis confirms that the fundamental strategy at this firm is brand loyalty. However, as stated above, interviewees believe that brand loyalty leads to customer loyalty.

The Relationship Between the Brand Loyalty Strategy and Firm Profitability

Because this firm's strategy is focused primarily on brand loyalty, the firm does not tailor marketing strategies to reflect a balance between new and retained customers:

Our strategies are based on the assumption that if it works for existing customers it will be attractive to new customers.

Our strategy is more targeted towards a balance between domestic customers and export customers.

However, a new customer strategy is seen as very important:

New customer strategy is very important. I have seen from our purchasing point that often firms can neglect their existing large customers, to chase new business.

While one interviewee found it easy to relate customer satisfaction or customer loyalty measures to accounting profits, another did not (Ittner and Larcker 1996):

No, this is very difficult. We have two sets of customers. The retailer and the consumer. Consumer loyalty is easier to translate into accounting terms. We can often do direct comparatives with loyalty programmes and their impact on sales. It is more difficult with the retailer because their loyalty affects a whole range of products. Retailer loyalty often is best seen in their response to new products and whether they are willing to endorse them.

As the firm does not have a customer profitability analysis system in place, they cannot break down company profits into customer profits. Despite the lack of information that the firm has regarding customer profitability, interviewees believed that following a customer retention strategy, based on brand loyalty, did lead to increased profitability on the firm:

If we don't retain customers [we] go out of business.

Yes, [following a retention strategy] on top of delivering a well priced quality product [leads to increased profitability of the firm]. However, the quality issue has lessened as quality is now taken as a given. Our competitive advantage rel[ies] on our ability to provide quick response with new initiatives because of the speed [with which the] market change[s]. This also gives us an advantage over import programmes. We want to be the first port of call when customers want advice on our product categories. We have performed customer surveys to identify areas where we can gain business advantage over our competitors.

For this firm, brand reputation is critical to the retention-profitability relationship (Selnes 1993):

Our customers tend to be loyal because of our strong brands.

Our ability to retain our strong brand oriented market position in New Zealand and to enter new markets [drives our profitability]. We rely on product development to provide some point of difference.

Customer profitability does not fit closely with our business strategy. We have very strong brands and concentrate more on analysing their profitability and what they can deliver for the retailer as well. With our major customers we work very closely on product categories and extensions, and often manage their house brand in conjunction with our branded product to give a desirable sales mix in-store. With many manufacturers closing or moving offshore due to tariff reductions, we see our delivery performance and ability to deliver new initiatives quickly as a way to offset some of the current price-driven mentality. We have shared our vision with our major retailers.

However, interviewees thought that customer profitability information may help in gaining a better understanding of the relationship between retention and profitability:

[Customer profitability information] may [help in understanding this relationship]. We try to retain nearly all customers and rarely turn away business. Perhaps we could be more selective and it would aid our profitability because some may be unprofitable. We [are] plan[ning] to try and build a model [to investigate this].

Although the firm believed following a retention-brand strategy did lead to profitability, profits have varied over the last years:

We have had increased profits in the past two years but this follows two poor years. This years profit projection is in line with profits in the early 1990's.

Our company was making returns on investment to shareholders consistently in excess of 25% up to 6 years ago. In the last 5 years we have had some very large changes in our industry with most local manufacturers...struggling to make adequate returns. The biggest change for us is a focus away from total manufacturing efficiency to flexibility and delivery performance. The Warehouse⁶⁵ influence over the retail sector has grown to currently 36% of department store sales. They have gained this market share from both chain stores and specialty stores. The Warehouse strategy has certainly put us under price pressure. Our return on investment dropped in '94 and '95 to a low of 12% in 1996. 1997 and 1998 have reversed this trend with 16% return on investment in 1997 and nearly 20% in 1998. This is on the back of a declining market. We budget 1999 to be over 20% return but aim to deliver 25% return on investment average over 5 years.

Also, interviewees believed there to be no guarantees that such a strategy would lead to profitability increases:

There are no guarantees. We are in an industry that is under huge pressure from reducing tariffs and proliferation of imports. We have a strategy that we feel best responds to our changing environment, but there are no guarantees. But we love a challenge!

Based on "gut feeling" it was believed that over time there had been a reduction in profit from new customers, compared with profits from retained customers:

Don't know but suspect yes as new business tends to be at a lower margin.

Chapter Summary

This chapter has presented the research findings of the second site, a New Zealand manufacturing firm. The firm informally follows a customer retention strategy, but its

⁶⁵ The Warehouse is a mega, low-cost, multi-purpose retailer.

dominant strategy is brand awareness, with a view that brand loyalty leads to customer loyalty.

As a result the firm does not have a customer profitability analysis system in place. Rather the management accounting systems focus on brand issues, providing information regarding brand profitability and shelf space profitability.

Interviewees believed that following a retention strategy – based on brand loyalty – did lead to firm profitability. Despite not having a customer profitability analysis system in place, the firm did believe that information from such a system may help in understanding the relationship between retention and profitability.

Chapter ten provides the energy company findings.

Chapter Ten: The Energy Company Findings

Introduction

Chapters seven and eight have provided the evidence from the bank and manufacturing firms respectively. The two remaining sites' evidence are presented in chapters ten and eleven. This chapter details the energy company findings.

The Customer Retention Strategy

At the energy company a customer retention strategy has been adhered to as the firm's dominant strategy for the past two years:

Yes, this firm has strategies in place for the retention of both its residential and business customers, who are managed in a different way due to their differing levels of contestability.

Retention strategies are very much the dominant strategies for our firm. The exception is with our liquid petroleum gas activities, where as a relatively recent player in an immature market, our focus has been on acquisition.

The firm has really been focusing on retention for business customers in the last two years, when contestability was introduced in the electricity market for larger customers. With respect to residential customers this retention focus has only truly emerged in the past twelve months.

Many authors have argued for the formal incorporation of a customer retention plan into firms' strategic plans (Stuchfield and Weber 1992, Reichheld 1994), and this is the practice followed at this firm:

A formal plan exists. The strategy is formalised in sales and marketing plans and business plans that relate to specific customer segments. Retention is the key objective for which there are targets and, on this basis, strategy is formalised as to how these objectives should be achieved.

The retention plan has key components for particular customer groups. For business customers it includes the following:

Cross-selling an additional fuel type, for example Liquid Petroleum Gas, to customers and bundling the price with their existing electricity offering, to ensure the offering is unique;⁶⁶

Proactive account management - where our sales people have a formal call-planning process in place, where they initiate the contact with the customer to understand if there are opportunities to better satisfy their needs, or to introduce new products/pricing options/fuels etc. At its lowest form it may be just calling to say hello, so the relationship is continually developed. This would contrast to passive account management (or order taking), where the sales person waits to be contacted by the customer;

Advertising that demonstrates the firm's support of local business;

Running seminars for business segments where information is fed back to customers and their feedback is sought (These techniques were discussed by Lowenstein (1996) and Drege (1991));

Customer Newsletters;

Sponsorship targeting specific business groups.

For residential customers the strategies:

have not been implemented to the same extent. However we have formulated a number of strategies. These include regular communication through newsletters, use of our continuous-service quality measurement and the provision of specific training for front line staff designed to retain customers during their service contracts. We are also trying to build more positive equity in our brand, using

⁶⁶ This is an example of cross selling (Drege 1991).

*vehicles such as our considerable community support, which is also broadly aimed at customer retention.*⁶⁷

Despite the claim that an employee retention strategy is important to a customer retention strategy (Sellers 1993, Reichheld 1993, Wilson-Ellis 1994), this firm does not have such a plan.

However, the firm does align compensation to the retention strategy (Post 1997) “*in some areas of sales*” and there is extensive training in service quality (Lian 1994) “*provided to staff to ensure the right level of service is provided at the right quality*”.

In line with Goldshlager (1993), the energy firm elicits customer feedback and acts on that information. The firm monitors customer needs:

The firm conducts a wide array of market research with existing and potential customers to understand customer needs.

The information is then used in the following way to close any needs-benefits gap that may arise:

Salient information that is produced from the above research is fed back to staff so that they have an opportunity to understand where customers are at, and start working to improve any areas of concern. At a management level, where it is clear gaps exist, in terms of need fulfillment, strategies are developed as part of the business and marketing planning process, to address these gaps.

Market research is undertaken on specific segments to understand any issues relating to dissatisfaction and these are subsequently addressed.

The energy firm uses the following customer retention techniques (Drege 1991): toll free telephone numbers; call backs; loyalty discounts: “*but only with our gas business with respect to bottle refills*”; cross-selling: “*across payment and product options, as*

⁶⁷ “The strategies...are commercially sensitive, so any greater detail cannot be provided.”

well as fuel types”; satisfaction guarantees: “we have guarantees in place that set out specific service benchmarks, which our firm pays out on if they are not met”; and feedback from customers: “we have a continuous-service quality management programme in place”.

However, the firm does not use customer clubs, comment cards, or recognition letters of appreciation (Drege 1991).

Aubrook (1997) and Johnson (1992) noted the importance of an information system to support a firm’s retention strategy. This firm does not collect information on customer demographics, spending patterns, product needs or causes of customer defections. However it does rely on customer profitability analysis information to support the retention strategy:

We are able to identify customer segments based on profitability, which is a function of their usage, pricing option and in the case of business customers, length of contract.

Dawkins and Reichheld (1990) focus on the necessity for the calculation of customer retention rates to measure the success of a customer retention strategy. This firm calculates and monitors retention rates on a monthly basis:

The rate is set as a function of the number of competitors in each market and our respective level of contracts in place with each customer group.

There are target customer retention rates established and these are compared with actual achievements.

A number of factors influence the firm to follow a retention strategy: it lowers costs associated with long time customers; it reduces costs associated with replacing lost customers; the purchase of a wider line of company products by long time customer

results in economies of scale; and there is increased revenue from referrals (Reichheld and Sasser 1990).

Content Analysis of the Annual Report

On the inside cover of the 1998 annual report, customers take a centre stage. After a single sentence describing the organisation, the firm states its commitment to meeting customers' needs as its primary role for the future.

The chairman's review is 14 pages long and the following references to customers are made. On page two, it states that "reliability of supply is the most important feature sought by customers". On page four, after an historical account of the organisation's development, reference is made to the "re-focusing of the business towards the customer". Customers are shown to include "residential and business customers" and on the same page there is a statement made concerning the need to "remove any cross subsidisation that may be occurring between these two distinct customer groups". On page five, the firm discusses its "retention of business customers", and its commitment to "providing the cheapest energy possible to residential customers". On page thirteen, the company states, as one of its aims, the desire to ensure the best possible retail deals for its customers, and then describes an amalgamation which should ensure lower retail energy prices for both categories of customers.

On the final page there is a very positive statement about the staff of this firm. It states that this firm is blessed with real depth of quality management and a loyal and innovative staff as a whole. There is also an expression of gratitude to staff for the last financial year.

Although there are many references to customers and one to staff in the chairman's review, they are hardly mentioned in the chairman's address. However, the organisation is in a time of dramatic legislative and industry wide change, so these issues dominate the report⁶⁸. Despite the contrast between the review and the address, the comments made about customers do indicate a customer retention strategy and thus the interpretations provided by the interviewees are supported. Also the one reference to staff does support the interviewees contention that employee retention is clearly not a strong part of the customer retention focus.

The Customer Profitability Analysis System

A customer profitability analysis system is a system capable of determining the profitability of customer groups. At this site, the system focuses on two distinct customer categories, namely business and residential. Because the company has over 150,000 individual customers it is "*impossible*" to calculate the profitability of individual customers. However, the profitability of customers is calculated based on the product purchased, for example, electricity or gas, and there is a particular focus in the system on the users of the gas service:

We perform one-off analyses for product options, rather than customer by customer - given 150,000 customers! Also, electrical energy is purchased on a half-hour by half-hour basis, some on the basis of hedge contracts and some on a spot market. Only major customers utilise the expense metering equipment needed to identify usage on the half-hour by half-hour basis. The customer who contributes to usage at a time when prices are very high cannot necessarily even be identified. Accordingly, it is very difficult [if not impossible] to accurately analyse individual customer profitability. However, for products such as gas we do more detailed analysis.

⁶⁸ The effect of this new competitive environment on the strategy-structure relationship is discussed in the contingent analysis undertaken in chapter fifteen.

For services to customers, the customer profitability analysis system shows characteristics of a second generation system. It uses activity costs and customer specific costs, although for electricity the cost of energy is the major cost category anyway:

For our gas sales analysis we have developed a system which uses net present value concepts over the contract period. This is especially relevant, as although certain fittings may be able to be recovered on contract cessation, the installation costs - piping etc - are non-recoverable. It was developed early this year, and attempts to allocate activity costs [such as cylinder refills] to the customer.

For electricity, we simply take the likely quantities of energy sold across different products; combine them to provide a total revenue; and compare them with the anticipated purchases we need to make on the wholesale energy market. Indirect administration and related costs are minimal, compared with energy purchases.

The activity cost information on customers is used to minimise customer costs:

Our use of activity based costing is strategic - for example, we calculate how much it costs us to have a customer pay by direct debit, or at our cashiers, or via an agency, then we attempt to encourage alternative payment methods.

The system does try to incorporate the life time value for customers: “We attempt to include contract lifetime concepts”, but in the energy industry it is extremely difficult to predict lifetime revenues and the interviewees were not confident with the predictions of lifetime revenues and costs.

Because of these difficulties, there was no distinction made between short and long term costs. Also standard costs do not apply in the model as the price of energy is determined in the commodities market:

Electrical energy is purchased on a half-hour by half-hour basis, some on the basis of hedge contracts and some on a spot market.

The Use of Customer Profitability Information to Support the Customer Retention Strategy

Information from the customer profitability information system is used to support the firm's customer retention strategy directly:

Not all customers are desirable from a profitability standpoint, particularly where competition is intense [for business customers at the time of writing, and becoming more so for residential customers as well]⁶⁹. Also, some customers have excessive management requirements which push up their transaction costs. Profitability information assists in prioritising activities and identifying who we need to retain.

However, product profitability and other cost information is also provided by the finance department staff to the marketing department because the product cost is so important:

Our marketing is also targeted around "social" aspects - such as community involvement, clean air, energy efficiency, pricing; and the like. Marketing energy efficiency is not altruistic - it reflects that using energy at peak times is expensive, as we need to build our electrical network to be able to supply at times of peak demand (maximum capacity may only be used for a fraction of the year) and that is also likely to be when generation is also expensive. Pricing also reflects these issues. Most accounting information provided to marketing is cost based..

⁶⁹ Note previous footnote regarding the changing competitive environment.

Customer profitability information is used at a strategic level:

Customer profitability analysis information is used in strategy formulation at a management level. Less information is used at a lower level with the implementation of strategy.

The information is used for price negotiation (Storbacka 1993, Booth 1994): “with individual business customers. We use our customer profitability information mainly in pricing rather than on an ongoing sense”; for segmentation (Petro 1990); for cross-selling; for analysing customer behaviour and to categorise customers, for example, target, convert, retain, drop:

To a limited extent we categorise groups based on customer profitability analysis information, but this largely relates to business customers.

This is because in the energy industry, apart from business customers, there is the social aspect of marketing activities, and it is socially unacceptable to “drop” unprofitable customers. However information is being used to manage the customer relationship through productivity improvements and account engineering (Bellis-Jones 1989):

Having customer profitability analysis information on all types of customers, we have altered our service delivery significantly over the past few years, so we have moved away from service at any cost, to looking more at ways to minimise transaction costs etc.

We use accounting information to forecast reductions in costs to customers by changing product options, or using gas at certain times etc. In many cases these involve capital expenditure, so net present value concepts are also relevant.

The Link Between Customer Retention and Firm Profitability

The energy firm balances retention and new acquisition strategies:

Yes, the different strategies are quite distinct and are in line with the overall direction of the organisation, in terms of growth or consolidation.

The firm assesses new customers based on a forecast of revenues and costs:

We assess likely revenue from a customer where new connections occur, based on our expectations of revenue compared with the costs incurred in adding to the network to supply that customer.

The firm's customer profitability analysis system produces a breakdown of customer profits: "we can identify profitability by individual customer [groups]".

However, there is still an element of estimation that comes into this analysis, cautioned the interviewees. Firstly, for this firm the principal cost is the product cost. Therefore, the customer groups that the model refers to are largely product types⁷⁰:

Total revenue can be quite easily determined for the group, but for profitability, even at gross margin level we need to assess a standard time of use profile (therefore purchase cost profile) for the group of customers; make some assumptions re line losses (typically 5% of energy into our network is not billed); assess the unbilled component by customer group (for example, a meter read on the 15th of the month contains roughly half the current month and roughly half the previous month) and thereby approximate gross margin by customer product. To take it to a net contribution we then need to allocate costs – more estimation.

We can make assessments at various levels, but because of our inability to directly relate energy purchase costs to customer groups they are only assessments.

Despite these limitations to the calculation of customer profitability, the model has shown lower profits from new customers as opposed to profits obtained from existing customers:

⁷⁰ This issue is discussed in detail in chapter fourteen.

As the market becomes more competitive, the pricing/service level required to acquire customers, is different [less profitable] to that required to retain existing customers.

Also, the firm has continued to show profit increases over the two-year period during which the strategy has been in place: “Profits have been increasing over time”. Profits increased 33% from 1996-1997 and increased 20% from 1997 to 1998.

It was strongly and firmly believed that there is a relationship between following a customer retention strategy and the long run profitability of the firm:

Absolutely! Following a customer retention strategy makes sound financial sense relative to expending all resources on strategies designed for acquiring new customers. The costs to retain customers are significantly lower than those associated with securing new ones. This has an obvious impact on the long run profitability of the firm.

Information from the customer profitability analysis system aids in this understanding:

This [relationship] is clear from the resources we expend on our sales and marketing efforts that are required to grow our customer base, with clients that are as profitable as those we already have. In this sense, understanding the profitability of customers individually and collectively is helpful.

However, it was also believed that other factors⁷¹ were important to the firm’s profitability:

For the energy business, volumes, customer numbers, and low cost operating structures [drive profitability]. For the line business, a natural monopoly, returns are ultimately capped at a fair weighted average cost of capital on funds employed. However, volumes of units distributed; the ability to utilise the network assets at a high level of load as frequently as possible (thereby avoiding building rarely-utilised lines); low-cost structures; and preventative maintenance are key to line business profitability.

⁷¹ Notice the reliance on multiple strategies. The bank also had this view as did the manufacturing firm. This issue is discussed in detail in the contingent analysis.

By a focus on cost reduction and improvement in earnings our profits have increased.

Despite this fervour, it was believed that it is not easy to directly relate customer satisfaction or customer loyalty measures to accounting profits:

No it is not easy to demonstrate this relationship. Customer satisfaction/loyalty does not always mean greater profitability. In some instances the level of profitability that is forgone to keep a customer satisfied is uneconomic. Satisfied customer will have greater inertia than dissatisfied customers, in terms of switching behaviour. But even satisfied customers will move which impacts on profitability, especially if considerable resources have been invested to try and satisfy them.

Chapter Summary

In this chapter the findings of the energy company were presented. The energy company follows a customer retention strategy as its dominant strategy. The strategy is consistent with the literature, apart from the non-inclusion of an employee retention plan.

The firm does have a customer profitability analysis system in place, with some of the aspects of a second generation analysis system (Foster and Gupta 1994a). However, interviewees showed caution regarding the system. Because the principal cost for this firm is the energy cost, and this cost is determined in the commodities market, a standard cost for the product cannot be used. This makes it difficult for the model to take a lifetime focus, although there is an attempt at such inclusion. Further, apart from large customers, which use a meter system, it is difficult to identify which customers are using which product at which time, and this fact greatly affects customer profitability.

Yet, given these limitations, customer profitability information is used to support the customer retention strategy at a strategic level. Also interviewees believe that following a customer retention strategy does lead to the profitability of the firm: “*Absolutely!*”

Information from the customer profitability analysis system helped the firm understand this relationship because the information assists in prioritising activities and identifying the type of customer to retain.

We now move to chapter eleven which details the courier company findings.

Chapter Eleven: The Courier Company Findings

Introduction

In chapter seven it was stated that four sites had provided the principal evidence for this thesis, and this chapter presents the last site's findings, namely the courier company. Cross-site analysis begins in chapter twelve.

The Customer Retention Strategy

The courier company follows a customer retention strategy:

We have a dedicated sales team in every one of our branches nationwide that are able to service and foster continuing relationships with our customers. For those smaller customers that do not require as much attention, a dedicated telephone sales representative is allocated.

However, the firm does not consider retention as the dominant strategy. The dominant strategy is brand recognition, with awareness that brand loyalty leads to customer loyalty (Selnes 1993):

The dominant strategy has been to be the number one courier brand in New Zealand by the year 2000.⁷² We have just achieved this milestone some 14 months ahead of time. Strategies such as customer retention stem from this overall strategy as it is obviously key in achieving a number one position.

⁷² This is also stated in the 1997 annual report: "Our vision of being the pre-eminent courier brand in New Zealand by the year 2000."

The customer retention strategy is incorporated into individual account plans for clients rather than as part of the firm's overall strategic plan (Reichheld 1994, Stuchfield and Weber 1992):

We have an account plan which incorporates customer retention. However there is no formalised customer retention plan.

Sellers (1993), Reichheld (1993) and Wilson-Ellis (1994) believe that an employee retention plan is necessary for successful customer retention and this firm focuses on its people:

Part of the strategy to achieve our number one position was (and still is) to develop and retain the best people in the industry – this has been rigidly adhered to.

In keeping with a focus on the employee–customer retention link, the firm aligns compensation with retention (Post 1997):

The firm operates a successful sales incentive strategy with monthly reports on the sales progress of individuals and regions. This provides links through to employees' evaluation, determining several factors, including bonus levels. Its structure also encourages top performance and incentive, allowing us to develop an excellent sales force that is motivated and driven.

The firm also uses service quality training programmes (Lian 1994):

Extensive and on-going training is given to each Account Manager.

Goldshlager (1993) notes the importance of identifying customer needs, and closing any needs-benefit gaps which may exist. This firm monitors customer needs in the following way:

There is regular contact [between the customer] and the Account Manager so that any issues can be discussed and acted upon immediately. There are a number of interfaces to try and make communication with the firm as seamless and easy as possible. We pay a great deal of attention to the information received from the account managers.

We also have a research monitor which we conduct, as well as monthly transit testing of the performance of our product [customers provide feedback on whether the product arrived on time, its condition, etc.].

This information is used in the following way to close the needs–benefit gap:

The account managers and telesales representatives undertake the follow up. From here the appropriate action can be taken. This may mean amendment or changes to our service or simply a sympathetic ear. Dependent on the complexity of the issue, the account manager usually has the discretion to deal with the problem.

The courier company uses the following customer retention techniques: toll free numbers:

0800 numbers and other touch tone phone services, for example, on-line freight management systems where clients can print their own tickets, track their freight and monitor its efficiency from their own personal computers and internet access is coming soon;

call-backs; cross selling; satisfaction guarantees; loyalty discounts: “included in the contract rate” and feedback from customers: “customer surveys.” However it does not use customer clubs, comment cards or letters of appreciation of custom (Drege 1991).

Aubrook (1997) and Johnson (1992) note the importance of a sophisticated information system to support a retention strategy, yet this firm does not collect or use information on customer demographics, spending patterns, product needs or the causes of customer defections.

Further, despite the recommendation of Dawkins and Reichheld (1990) for the measurement of the success of a customer retention strategy, customer retention rates are not calculated.

The firm follows a customer retention strategy for a number of reasons identified in the literature, namely, it lowers costs associated with long time customers; it reduces cost

associated with replacing lost customers; the purchase of a wider line of company products by long time customer results in economies of scale; and there is increased revenue from referrals (Reichheld and Sasser 1990). The following comment was made:

The lifetime value of a customer is far greater than a continual turnover of unsatisfied customers. This also does large damage to your brand.

Content Analysis

The Chairman's report is two pages long, and relates to all the subsidiaries of the company. The following comments regarding customers and employees were made:

We have invested in technology and the capabilities of our people.

Consistent with our business scope, we must have the freedom to be creative and innovative in the products and services we offer our customers, which in turn will strengthen the company.

A competitive market leads to new growth and better value for customers...

My thanks to ...all the people...for their efforts in the past 12 months.

The firm states five business principles:

[Number one is:] providing reliable, efficient services at the lowest cost and lowest price to meet customer needs; [Number five:] Valuing our people and being a good employer.

The Chief Executive Officer's report is one page long, relating to all subsidiaries, and the following references to employees and customers were made:

A key strategy in recent years has been to shift the focus of every person in [the firm] to a ... service orientation.

There are four key objectives described. "Winning Customers" is one and, later in the report, two pages are devoted to describing this objective and how it is measured using

customer satisfaction and service performance delivery measures undertaken by external and independent bodies.

Another objective is:

Building Relationships with our business partners, our people and the community.

Two pages are also devoted to this objective and it is measured using an employee satisfaction index and a health and safety index. Both of these relate to employees. The other measure is an assessment of public favourability.

Other comments regarding employees were made:

...we look behind the targets for the drivers of performance so that our people can acquire new knowledge and insights into their role. My thanks to ...employees...for making [the firm] the best company in New Zealand.

[Our] people talk about ... service [and] quality. They are exactly the elements and values sought by our customers – large corporates, small businesses, the householder, the farmer. They symbolise the strength of [our firm]. We are determined to uphold the trust you hold in [our firm].

This analysis shows strong support for an employee and customer focus that supports the interviewees' comments.

Customer Profitability Analysis System

Despite the importance of the strategy to this firm there is not a customer profitability analysis system in place:

Customer profitability analysis is an area to improve upon.

We use a pricing model to help answer various marketing issues. This is currently under review and the adoption of activity based costing is our next option.

However, individual account managers have:

A profitability model from which they construct each customer's rates. This ensures proper margin and profitability are achieved. Volumes and type of product sent from customers are monitored periodically with a freight audit occurring usually each year. If there have been substantial changes to their freight patterns, this profitability model is revisited. While this manner will not give you your profitability and margin information at any given point in time, this process does provide us with some information and handle on profitability and margin.

Although this model, provides a margin – the difference between revenue received and cost of service provided - the information in this model is not really customer profitability, because it does not consider customer demands on services outside of the courier charge.

The firm does not use this, or any other form of customer profitability analysis information, for price negotiation or cross selling, For segmentation and managing the customer relationship, revenue information dominates the analysis:

As customer profitability analysis information is not readily available, the relationship is usually managed from an account potential or account size perspective.

Link Between Customer Retention and Firm Profitability

The courier company does tailor marketing strategies to reflect the appropriate balance between new and retained customers. Despite calls in the literature to focus the strategy on the most profitable customers, (McCormick et al 1996) this firm determines high value customer based on revenue:

As customer profitability analysis information is not readily available, the relationship is usually managed from an account size or account potential perspective.

Ittner and Larcker (1996) found that managers believed it difficult to equate marketing strategy with accounting profits. At this firm the view was consistent:

It is not always easy to demonstrate this relationship. It is quite often deemed intangible. Traditionally goodwill is the closest the accounting function has got to this type of measure.

However, interviewees believed that following a customer retention strategy did lead to profitability of the firm:

Because the lifetime value of a customer is far greater than a continual turnover of unsatisfied customers. Profitability is in part the result of an established customer base.

Also the firm has been following a brand leadership-customer retention strategy and has achieved its target growth expectations:

The targeted growth has been 20 % each year, set in 1995, which we have achieved.

Despite many authors suggesting that a customer profitability analysis system may help in understanding this relationship (Petty and Goodman 1996, Stuchfield and Weber 1992, Foster and Gupta 1994), this firm does not have such a system in place. Total firm profits cannot be broken down into customer profits and interviewees believe that: “This relationship can be shown and explained through historical sales patterns”.

Chapter Summary

This chapter has presented the findings of the final case study site - a courier firm. This firm does follow a retention strategy, but it is seen as flowing from the dominant strategy which is brand leadership. This is the only site which incorporates an employee retention focus into the strategy.

Due to the dominance of the brand leadership strategy, the firm does not have a customer profitability analysis system in place, although the company is in the process of reviewing its management accounting information systems. They currently use a pricing model and are in the process of designing an activity based costing model to determine product cost.

The firm believes that following a customer retention strategy, based on brand leadership, does lead to firm profitability:

The lifetime value of a customer is far greater than a continual turnover of unsatisfied customers. This also does large damage to your brand.

However, interviewees believe that this relationship can be sufficiently understood based on revenue information only, not customer profitability information.

Having concluded the presentation of the findings from the four sites, cross site analysis begins in chapter twelve.

Chapter Twelve: Cross-site Analysis: Organisational Strategies

Introduction

The purpose of this chapter is to begin the cross-site analysis which is presented in three chapters. Chapters eight through eleven provided the detailed evidence collected for the four sites, and many differences between the four sites were evident. In order to explain these differences using the contingent framework presented in chapter five, it is necessary to consolidate the main differences. To this end, a summary of the main findings is presented and if one wishes to see the detailed evidence⁷³ they should refer back to chapters eight through eleven.

The first theme of the cross-site analysis comprises an assessment of the differences in the organisational strategies. The term organisational strategies is used because customer retention was not the dominant strategy in all four sites. Bruggeman and Van der Stede (1993) state that there is little research evidence showing the alignment of cost systems with multiple strategies. The sites in this study provide this opportunity.

Also Carroll (1991-992) criticised the professional literature relating to customer retention. He argued that customer retention was being offered as a “cure all” - follow a customer retention strategy and you will be profitable. These sites show that this view is not a reality.

⁷³ In some instances parts of quotes or content analysis is repeated where it facilitates analysis.

However, as all four sites were following a customer retention strategy, albeit to varying degrees, this chapter relies on the framework outlined in chapter two on customer retention to compare and contrast the strategies in place at the sites. The next two chapters deal with customer profitability analysis, and the relationship between customer retention, customer profitability and firm profitability respectively.

Organisational Strategies

As shown in chapter three, a customer retention strategy constitutes a business plan for maintaining and retaining a firm's existing customers. All four sites were following this strategy in different ways.

At the bank six customer groups are identified and the retention strategy focuses on four of those six customer groups. The four groups are considered to be "high value" customers and hence the focus of the retention strategy. High value is "*principally determined by total footings [balances] with the bank.*"⁷⁴

At the energy company, the customer retention strategy is viewed as the dominant strategy of the firm and it focuses on two categories of customers, namely business and residential. Customers are defined based on their profitability.

At the manufacturing firm, there is not a structured retention strategy, rather it is tied in with brand loyalty. However, there is an awareness of the importance of keeping customers, and for the elements of the retention strategy in place, the focus of the strategy is on the "*Top 50 customers by turnover.*"

⁷⁴ All statements in italics are repeated quotes from interviewees.

At the courier company, the retention strategy is also intertwined with a brand strategy, namely brand leadership. There is a strong focus on keeping customers, with two categories of customers, large customers dealt with by account managers and a “*dedicated sales team*” and “*smaller customers, [that have] a dedicated telephone sales representative allocated.*” Customer size is determined by turnover⁷⁵.

The differences in the adoption of these strategies can be explained⁷⁶. Although much of the literature on customer retention is based on research in banks, the interviewees from this bank did not believe that it was wise to focus solely on a retention strategy. Although aware of the “*overseas research*” on following a retention strategy this bank had chosen to mix acquisition (of new business), profit driving and retention strategies together. The reason for this was that interviewees had witnessed their competitors spend “*a great deal of money on customer retention*”, more than this bank, and yet this bank had outperformed its competitors profit-wise.⁷⁷

The manufacturing firm, on the other hand, follows a retention strategy indirectly, and for this firm this was seen as a good strategic choice. This firm, unlike the two discussed above, have brand-name products and believe that the brand leads to profitability⁷⁸ and that the brand aids in keeping the customer. In the chairman’s address in the annual report, the following comments were made:

⁷⁵ Although there is some form of customer profitability information used which is discussed in chapter eleven.

⁷⁶ An analysis of the contingent nature of strategy adoption is reserved to chapter fourteen.

⁷⁷ This view casts doubt on the relationship between customer retention and firm profitability which is discussed in chapter thirteen.

⁷⁸ This result is consistent with Selnes (1993).

brand awareness raised throughout the year... The divisions', continuing product development initiatives have strengthened our stable of very important brands. A large number of new product initiatives have received strong trade support and consumer acceptance.

The energy company, however, has and will continue to follow a retention strategy as its key strategy. This firm is in an industry undergoing deregulation⁷⁹. Up until two years ago, they had a monopoly in both residential and business supply. Because this monopoly has now been removed, the interviewees were very aware of the need to maintain profitability by retaining as much as possible of its customer base⁸⁰.

The courier company is taking a similar approach to the manufacturing company, but rather than just brand awareness and loyalty, the target is brand leadership by the year 2000. They are also very aware of the link between brand leadership and customer retention.

As discussed in chapter seven company-wide commitment to a retention or other strategy can be achieved through the corporate mission statement. An efficient vehicle for this communication is the chief executive officer's and director's reports published in the company's annual report. This research used content analysis on the firm's annual reports to view the firms' commitment to the strategies described by interviewees.

Despite the bank interviewees commenting that the retention strategy was "*not as strong as the profit driving and acquisition strategies*", the annual report focuses on the customer, rather than the other two strategies. There is no reference made to the

⁷⁹ In chapter fifteen, the effect of industry deregulation and competition on strategy selection is analysed.

⁸⁰ However, the firm is also aware of the need to focus the strategy on profitable customers.

acquisition strategy and only two comments were made about the profit driving strategy. The analysis⁸¹ showed significantly more comment relating to customer issues.

For the manufacturing firm it is clearly brand awareness that is the strategic focus, both within (interviewee comments) and outside the firm (annual report).

The energy company stated that: “Our primary role is looking to the future needs of our customers.”

For the courier company there was no reference to the brand leadership strategy in the 1998 report, however it was focused on in the 1997 report: “Our vision [is to be] the pre-eminent courier brand in New Zealand by the year 2000.”⁸²

In summary, the four firms’ approaches to strategy are shown in Table 12.1.

Bank	Energy	Manufacturing	Courier
Customer retention Profit driving Acquisition of new business	Customer retention	Brand positioning and awareness Customer retention based on brand loyalty	Brand leadership Customer retention based on brand leadership

Table 12.1 The Firms Strategies

The Relationship Between the Customer Retention Strategy or Plan and the Firm’s Strategic Plan

Stuchfield and Weber (1992) and Reichheld (1994) believe that a customer retention plan should be incorporated into a firm’s strategic plan to ensure that customer retention becomes part of the firm’s strategic focus. The sites investigated here support this

⁸¹ Provided in chapter eight.

⁸² These annual reports relate to the firm and all its subsidiaries. There is not an individual report produced for the courier company.

recommendation, in the main, although the courier company takes a slightly different approach.

At the bank, the “*various customer retention plans, related to the particular high focus customer groups*” were part of the firm’s three year strategic plan.” In keeping with the informality of the strategy at the manufacturing firm, there was no formal recognition of the strategy in the firm’s strategic plan. At the energy firm, a formal customer retention plan was established as being “*the key objective.*” For the courier company, retention is reflected in each individual client’s account plan, although “*there is no formalised customer retention plan.*” These results are summarised in Table 12.2.

Bank	Manufacturing	Energy	Courier
Customer retention plan included in three year strategic plan	No formal plan	Formal customer retention plan	No formal plan Individual client plans

Table 12.2 Form of Customer Retention Plan

Employee Retention and Customer Retention

Many authors (Sellers 1993, Reichheld 1993, Wilson-Ellis 1994) have stressed that, as employee retention has a fundamental impact on customer retention, an employee retention plan is essential for firms following a customer retention strategy. The employee retention-customer retention link suggests that staff get to know frequent customers and their needs. An interesting finding of this research was that interviewees at all sites, except for the courier company, believed there was not a focus on employee

retention nor was there an employee retention plan. The courier company provides the only example of a site supporting this link: “to achieve a number one position⁸³, [we need] to develop and retain the best people in the industry – this has been **rigidly adhered to**” (emphasis added). Table 12.3 shows the references made to employees in the annual reports.

Bank	Manufacturing	Energy	Courier
<p>A focus on People: The group continued to focus on its people...to maximise the understanding [that] the roles of staff at all levels have in the achievement of group objectives.</p> <p>The group has launched a team based leadership model to encourage ownership, involvement and creative contribution of staff.</p>	<p>In what has traditionally been a very high staff turnover industry it is pleasing to note that for the first time in several years, staff turnover has reduced to below 20% for operator level staff.</p> <p>During the year our focus was also maintained on improving the health and safety of our employees.</p> <p>Recognised for its family friendly policies.</p>	<p>[The firm] is blessed with real depth of quality of management and a loyal and innovative staff as a whole.</p> <p>There will be considerable demands on staff which has already had to cope with a great deal of change.</p> <p>I express my sincere appreciation to all...staff for their support during the year.</p>	<p>We have invested in ... the capabilities of our people.</p> <p>My thanks to ... all the people...for their efforts in the past 12 months.</p> <p>Business principle: Valuing our people and being a good employer.</p> <p>Building relationships with employees – measured through an employee satisfaction index and a health and safety index.</p> <p>We look behind the targets for the drivers of performance so that our people can acquire new knowledge and insight into their roles.</p>

Table 12.3: Annual Report References To Employees

Relative to the references made to customers, particularly for the bank and energy firms, depicted in Table 12.3 above, there appears to be less of a focus on employee retention,

⁸³ Note the importance of being number one and how customer retention fits in with that objective.

except for the courier company. Apart from the courier company, interviewee comments concur with the lack of focus on employees.

The reasons for the lack of employee retention plans were made very clear by the interviewees⁸⁴ of all except the courier firm. The following quotes reflect the general feeling:

There is almost an arrogance that exists towards employees, that may have as much to do with our small job market, and the perceived ease of replacing staff. Ironically it never ceases to amaze me how often I've heard managers whining about the difficulty of replacing a capable employee.

This country [New Zealand] is a long way behind a number of European countries and the States in the way we manage and develop human resources. Essentially whilst the concept of staff being the most important asset is articulated widely, it is seldom committed to in practice.

Perhaps this is an evolutionary thing, where the process of understanding all of the costs of replacing employees needs to become widespread before employees are thought of in similar value terms as customers.

In my view few companies actually have their minds around the true costs of not retaining customers, so it is little wonder employees are not considered in this way.

Despite the lack of corporate focus on employee retention by all firms, except the courier company, the bank, energy and courier firms all rely on techniques that have been recognised in the literature as encouraging employee commitment to customers. These techniques include service quality training programmes (Lian 1994) and compensation aligned to retention (Post 1997). Although the literature views these

⁸⁴ Other quotes from bank interviewees were provided in chapter eight.

techniques as forming part of the employee retention customer retention link, at the bank and the energy firm both of these strategies were extensively used. Reference to the use of the technique is reinforced in the bank's annual report: "[The bank] *introduced comprehensive sales and service training programmes and began installing new computer software to transform front-line customer consultations.*" At the manufacturing firm, neither technique was extensively used. These results were expected because the manufacturing firm has a very informal approach to customer retention. A summary of the findings regarding employee retention are presented in Table 12.4.

Technique	Bank	Manufacturing	Energy	Courier
Employee retention plan	No	No	No	Yes
Employee focus	Minimal	Minimal	Minimal	Strong
Compensation aligned to retention	Yes	No	Yes	Yes
Training in service quality	A comprehensive bank wide sales and service training programme	No	Service and quality training	Extensive account manager training.

Table 12.4 Cross-site Analysis of Employee Retention

Monitoring the Customer Needs-Benefit Gap

Goldshlager (1993, 15) recommends that companies following a customer retention strategy should monitor a customer's needs, monitor any needs-benefit gaps that may arise and close these needs-benefit gaps. The four firms undertake the following customer needs analysis as shown in Table 12.5.

Action	Bank	Manufacturing	Energy	Courier
Monitor customer needs	Through staff feedback, customer feedback and national and international market research	Through staff feedback, customer feedback and customer needs surveys (major one 12 months ago)	Market based research with existing and potential customers.	Regular contact between the customer and the account manager. Market research monitoring and transit testing service performance
Close needs–benefit gap	As part of the strategic planning process.	In the business planning process and “ <i>happens everyday</i> ”	Strategies developed to close the gaps.	Account manager and telephone sales representatives follow up and appropriate action is taken

Table 12.5 Customer Needs-benefit Analysis

As Goldshlager (1993) recommends, all four firms similarly identify the needs of customers and gaps that may exist, then strategies are built to close those gaps. This is an interesting result, given the differing levels of commitment of these firms to a customer retention strategy, as previously discussed.

Customer Retention Techniques

Drege (1991) identifies a range of customer retention techniques. Cross-site comparison of the use of customer retention techniques is shown in Table 12.6.

Technique	Bank	Manufacturing	Energy	Courier
Toll Free Numbers	Yes	Yes	Yes	Yes
Call Backs	Yes	Yes	Yes	Yes
Customer Clubs	Yes	For certain customers	Not applicable to this industry	No
Loyalty Discounts	Fee rebates and volume discounts.	Volume discounts	For the gas business	Included in the contract rate.
Comment Cards	Yes	For some brands	No	No
Cross selling	Yes	Yes	Yes	Yes
Recognition Letters	Yes	To key customers at Christmas	No	No
Satisfaction Guarantees	No	On all products	Specific benchmarks paid out if not met	Yes

Table 12.6 Retention Techniques

These results show no significant differences in the use of the retention techniques, despite the varying levels of commitment to the strategy.

Calculating Retention Rates To Monitor A Customer Retention Strategy

Lowenstein (1996) believes customer retention rates should be calculated to determine whether the customer retention plan is working effectively (Dawkins and Reichheld 1990). Retention rates should be calculated for each line of business and these rates should be compared with those of previous periods and those of competitors. Johnson (1992) provides two measures for calculating a company's customer retention rates: the share of revenue from repeat sales to existing customers compared to new sales to first time customers; and the share of each customer's requirements purchased from the company as opposed to its competitors. Srinivasan (1996a) believes that the latter measure best reflects customer retention. Customer Retention Measurement is shown in Table 12.7.

Bank	Manufacturing	Energy	Courier
Churn rates new customer gained versus existing customers lost on a product basis but not all bank customers. Targets set for parts of the strategy.	Market share information compared to competitors Targets not set	Target retention rates compared to competitors Monitored on a monthly basis	Not calculated Targets not set

Table 12.7 Customer Retention Measurement

The bank's churn rate is consistent with the share of revenue from repeat sales to existing customer's compared to new customers. In line with the predominance of two other strategies (profit driving and acquisition), the measurement of this strategy is not complete: "*for some products.*" For the energy and manufacturing firm, the second measure, share of each customer's requirements purchased from the company as opposed to its competitors, is the measure used, although the manufacturing firm is less "formal" in its approach. These variations reflect the level of commitment to the strategy. At the energy firm the retention strategy is the key strategy and the measurement system reflects that⁸⁵.

⁸⁵ At the bank, two other strategies dominate, profit improvement and acquisition. Other measurements are determined to support these strategies. For the manufacturing firm, measurements of brand penetration and brand awareness dominate the analysis. Because the courier company strategy is brand leadership, market share dominates the measurement system. Also individual account managers have customer retention included in the account plan, at an individual customer level. A discussion of these strategy-cost system alignments will be provided in chapter fourteen – the contingent analysis.

Reasons for Following a Retention Strategy

Reichheld and Sasser (1990) believe there are a number of reasons for following a customer retention strategy. The reasons for following the strategy in each site are presented in Table 12.8.

Reason	Bank	Manufacturing	Energy	Courier
Lower costs are associated with long time customers	Yes	Yes	Yes	Yes
Reduces costs associated with replacing lost customers	Yes	Yes	Yes	Yes
Purchase of a wider range of company products by long time customers results in economies of scale	Yes	Yes	Yes	Yes
Increased Revenue from Referrals	Yes	No	Yes	Yes

Table 12.8 Reasons for Following a Retention Strategy

The reasons for following the retention strategy are consistent with the literature at all sites, except for the increased revenue from referrals at the manufacturing firm. Again this probably reflects the more limited focus on customers compared with brands.

Chapter Summary

This chapter has described the key strategies identified at the four firms and in particular, compared the application of the customer retention strategy described in chapter three. It shows that the four firms have different levels of commitment to the retention strategy, the energy company showing the most significant level of commitment. For this firm, the application of the strategy is predominantly consistent with the literature with the notable exception of the focus on employee retention.

For the bank, the firm follows the retention strategy, but it is one of three dominant strategies. Because of this, the measurement of the strategy is less than that

recommended in the literature. This site also does not have an employee retention plan or focus.

For the manufacturing firm, despite brand awareness and loyalty being the firm's dominant strategy, several components of a customer retention strategy are followed. However, the plan is not part of the firm's formal strategic plan. There is no employee retention plan or focus, there is minimal service quality training and compensation is not tied to retention. Finally, retention is only "*casually*" measured.

Finally, for the courier company, the dominant strategy is brand leadership, but there is a strong awareness of the relationship between customer retention and brand leadership. The company is the only site to focus on employee retention – a result consistent with the literature. The customer retention plan is not incorporated into the firm's strategic plan. Rather, the account plan for individual customers incorporates customer retention. As a result, the firm did not undertake customer retention measurement at a corporate wide level. This is handled by account managers, at the individual account level.

The chapter summary has provided a précis of the above description and analysis. The contingent nature of these findings will be discussed in chapter fourteen providing theoretical developments.

In the literature in chapter five it was suggested that if a firm is following a customer retention strategy, then it should have a customer profitability analysis system in place so that the firm can focus the strategy on the most profitable customers. This issue is covered in the next chapter.

Chapter Thirteen: Cross-site Analysis: Customer Retention and Customer Profitability Analysis

Introduction

This chapter continues the cross-site analysis focusing on customer profitability analysis and customer retention. It was prescribed in chapter five, firms following a customer retention strategy should retain only profitable customers (Morrall 1994, Filip 1994, Ellis 1995, Duboff 1992). To facilitate this strategy, a management accounting information system capable of determining the profitability of customers is seen as important. A customer profitability analysis is an accounting system which is capable of identifying the profitability of individual customers or customer groups (Foster and Gupta 1994a).

This chapter compares the customer profitability analysis systems in place at the sites. The interesting feature that emerges from this chapter is that, despite all the firms' commitment to a retention strategy, only two of the sites have a customer profitability analysis system in place. This apparent strategy-cost system non-alignment is discussed in detail in the contingent analysis presented in chapter thirteen.

Description of the Customer Profitability Analysis Systems

A customer profitability analysis system provides management with information regarding the profitability of individual customers or customer groups. Both the bank

and the energy firm have this kind of system in place, but the courier and manufacturing firms do not. These findings are shown in Table 12.1:

Bank	Manufacturing⁸⁶	Energy	Courier
In use May 1988	Not in use but are looking at it	In use with the strategy for two years	Not in use and not being considered

Table 13.1 Sites' Status Of Customer Profitability Analysis Systems

The energy site uses the information at the level of strategy formulation, where as the bank uses information from the model at an operational level.^{87 88}

The level of sophistication of a customer profitability analysis system is dependent on its approach to costs and revenues. Typically, second generation analysis (a higher level of sophistication) incorporates lifetime analysis; short and long-term costs are distinguished; and cost hierarchies are determined (Bellis-Jones 1989, Storbacka 1993, Foster & Gupta 1994a, Berry & Britney 1996). Also, the more sophisticated systems will incorporate standard costs for products, and activity based principles (Hartfeil 1996⁸⁹, Smith and Dikolli (1995.) The bank and energy firms' approaches to these factors is presented in Table 13.2

⁸⁶ As the manufacturing and courier companies do not have customer profitability analysis systems in place, they are no longer included in the cross-site analysis on customer profitability analysis.

⁸⁷ Reasons for this variation are presented in the contingent analysis – chapter fourteen.

⁸⁸ It is important to note, that in chapter four some key issues were identified regarding customer profitability systems that related solely to banks, for example, transaction intensity, risk and revenue issues. These issues were addressed in chapter seven, the bank findings. As this chapter deals with cross-site analysis, only the issues applicable to both sites are reiterated.

⁸⁹ Hartfeil (1996) also identifies origination and delinquency costs. However, as these issues relate only to banks, they are not included in the analysis presented in this chapter but were discussed in chapter seven.

Factor	Bank	Energy
Life Time Analysis	Prediction 12 months out	Attempt to include contract lifetime concepts but difficult because of the changing price of electrical energy
Short and Long Term Costs	No	No
Cost Hierarchies	Customer specific costs called direct overhead Indirect costs includes all other costs	For gas sales Not for electricity as indirect costs are minimal
Standard Costs	Yes	Do not apply in this industry
Activity Costs	Through net business manager time spent adjustment	Yes

Table 13.2 Level of Sophistication of the Customer Profitability Analysis Systems

Foster et al (1996, 11-16) identify the major “challenges” to producing accurate and reliable customer profitability information: developing reliable revenue figures; developing reliable cost figures; recognising future downstream costs and incorporating a multi-period or lifetime analysis which requires that profitability of customers is traced and budgeted for extended periods of time.

For both companies, lifetime analysis is difficult to achieve, as a result, neither firm distinguishes between short and long term costs. There is difficulty in recognising different drivers of customer costs for the energy firm but the bank is able to recognise the different drivers of customer costs more easily through an adjustment made by the manager for the time spent on a customer. However, this adjustment is then apportioned to the whole customer group, thus an element of cross-subsidisation must occur within the group. But both firms have too many customers – 150,000 at the energy firm – for the level of analysis to be more than on the basis of a group.

Of the four sites included in this study, only two firms – the bank and the energy firm - have a customer profitability analysis system in place. The courier firm realises “*it is an*

area we need to improve on” and the manufacturing firm “has intentions of introducing this form of analysis.”

For the bank and energy firms, there is effort being made to get sophistication into the systems with many aspects of second generation analysis being included in the models. However, major obstacles include lifetime analysis and the impact that has on the determination of accurate revenues and costs.

The Relationship Between Customer Retention and Firm Profitability

It has been suggested that a focus on customer retention leads to improved profitability (Drege 1991, Reichheld 1993, Srinivasan 1996, Passikoff 1997). However to date there has been “no definitive empirical data to support an absolute link between customer service (retention) and profitability” (Lash 1989, 8).

Ittner and Larcker (1996, 2) comment that: “the traditional customer satisfaction survey methodologies used by most companies suffer from a number of limitations that make it difficult, if not impossible, to directly link increases in these indices to increases in financial performance...Only...27 percent of respondents felt they could relate customer satisfaction measures to accounting or stock price returns.”

In this research, interviewees were asked: “Do you believe it is easy to directly relate customer satisfaction or customer loyalty measures to accounting profits?” The views expressed by all but one interviewee supported the conclusions reached by Ittner and Larcker (1996), that it is difficult to relate the two. Interviewees stated that many factors influence this relationship, which are difficult to reflect in accounting numbers. These include the range of products purchased, the willingness of satisfied customers to move, and that the level of service required to keep a customer can be uneconomic. The

courier company believes that customer satisfaction and loyalty is factored into a goodwill calculation rather than total profitability.

Reichheld (1996, 62) comments: “Intuitively, all of us have always known that customer loyalty [retention] was a good thing...[b]ut few of us have grasped its direct link to profits.” Some authors have conducted research examining this relationship and the results of these studies were presented in detail in chapter four. They included the work of Pelham (1997), who examined the relationship between market orientation and profitability of small firms; Ennew and Binks (1996), who sought to add empirical evidence to the relationship between loyalty, retention and profitability, with evidence from the United Kingdom banking industry; Selnes (1993), who investigated the relationship between customer satisfaction, brand reputation and customer loyalty, and highlighted the importance of brand reputation to such a link; Page et al (1996), who developed a model to predict whether customer defection (the opposite of customer retention) affected firm performance; and Shanahan and Sowden (1995), who undertook a pilot study which attempted to investigate the relationship between customer retention and profitability through a survey of the Top 40 New Zealand Companies. The overall results suggested no relationship between retention and profitability.

In order to add to the above studies, interviewees were asked: “Do you believe there is a relationship between following a customer retention strategy and the profitability of the firm?” The energy firm interviewees were convinced of the relationship between retention and profitability. For this firm, it is also the dominant strategy. However, cost reduction is also seen as a profit driver. For the manufacturing and courier firms, a positive relationship between retention and profitability is believed to exist, but both firms believe that this relationship is mediated by brand reputation. These views

support Selnes (1993). However, the manufacturing interviewees are more cautious, warning that many factors influence this relationship and as such there are “*no guarantees.*”

The bank interviewees are less enthusiastic towards the relationship between retention and profitability. Respondents are aware of the overseas research on the relationship between retention and profitability. As was noted in chapter four, much of this research is provided by consultancy firms. Despite this knowledge, the interviewees believe bank profitability is influenced by a range of factors and that it is too simplistic to view it based on the single strategy of customer retention. These views support the focus of this firm on the bank on three dominant strategies, namely profit driving, acquisition and retention. Table 14.1 summarises the key elements considered to determine firm profitability.

Bank	Manufacturing	Energy	Courier
Acquisition of new business Customer retention Balancing acquisition and retention Profit driving – stopping profit wastage	Strong brands Product differentiation Quick response and on-time delivery Delivering a well priced quality product – less so as quality is a given Customer retention	Customer retention – numbers and volume Low cost operating structures	Brand leadership Customer retention

Table 14.1 Determinants of Firm Profitability based on Interviewee Responses

The interviewee comments regarding strategy were then linked to firm performance. All four firms have been showing profitability improvements. This evidence is provided in Table 14.2.

	Bank	Manufacturing	Energy	Courier
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Strategies	Profit Driving Acquisition and Customer Retention	Brand Positioning and Awareness Customer Retention based on Brand	Customer Retention	Brand Leadership Customer retention based on brand
Profit	Profit increasing through the mid 1990's – a 5% increase from 1996 – 1997 and the strategy has not changed	Increased profits in 1996 and 1997 Return on Investment 1996 12%; 1997 16%.	33% increase from 1996-1997 20% increase from 1997-1998	Targeted growth of 20% each year (set in 1995) achieved

Table 14.2 Firm Strategy and Firm Performance

Customer Retention, Customer Profitability Analysis and Firm Profitability

In the management accounting literature, Petty and Goodman (1996, 55), Stuchfield and Weber (1992, 74) and Foster and Gupta, (1994, footnote 15, 58) argue for the need to examine the relationship between firm performance and customer retention based on customer profitability information.

Many other authors, in different disciplines, have encouraged the same approach including Gloy et al (1997) in the agricultural industry; Morrall (1994, 65) arguing for the importance of customer profitability information to the implementation of a retention strategy; Costanzo (1995) showing how Chemical Bank focuses its marketing strategy on its most profitable customer groups as evidenced by information from its customer profitability analysis system; and Filip (1994, 72) believing that a firm must focus its retention strategy on the most profitable customers.

Many consultancy firms are advocating this position, moving away from the focus on retaining customers per se to retaining the profitable groups and tailoring marketing strategies to those groups. For example, Elliot et al (1996) argue for banks to market to their best customers. Carroll (1991-1992, 20) cautions firms not to blindly follow a retention strategy; he makes it quite clear that a retention strategy must be based on an information system that can measure the profitability of individual customer relationships. Duboff (1992) also made a plea for marketers to analyse and manage a **profitable** customer base.

Despite these calls for organisations to focus on profitable customers only, research shows that organisations lack such a focus, due in part to the lack of appropriate information systems. Bitran and Mondschein (1997, 109) comment that “66% of direct marketers neither compute nor track customer lifetime value”⁹⁰ and Della Posta (1991) reports that only 22% of firms conducted analysis of customer lifetime value in the catalogue industry.

Clearly, the importance of a customer profitability analysis system to successful customer retention is being called for in the literature, yet although all four companies are following a customer retention strategy, albeit to varying degrees, not all firms have customer profitability analysis systems in place. Two firms have customer profitability analysis systems, which show some of the components of a second generation customer profitability analysis system as described by Foster and Gupta (1994a). The remaining two firms do not have such a system, although for the courier firm individual accounts

⁹⁰ Chapter four showed that customer lifetime value was seen as equivalent to second generation customer profitability analysis.

are managed by an account manager, based on product volume and price, which is monitored periodically. However, this analysis is only to the level of gross margin⁹¹.

A customer profitability analysis system is supposed to provide a firm with relevant information to implement a retention strategy. Information should be used to ensure that retention and acquisition of new customers is tailored to the most profitable groups. The four firms do tailor the retention strategy between new and existing customers to varying degrees. The bank balances acquisition and retention of new customers; the energy firm has distinct strategies for acquisition and retention and the courier firm targets both existing and new customers. The manufacturing firm is concerned with balancing domestic and export customers. However, due to the varying levels of customer profitability analysis information, high value customers - the focus of targeted acquisition and retention - are determined in three firms by revenue based information as shown in Table 14.3.⁹²

⁹¹ In chapter fifteen – the contingent analysis - we do examine the alignment between strategy and cost systems.

⁹² The issue of substitutability of management accounting information to support marketing strategy is reserved to chapter fourteen.

Bank	Manufacturing	Energy	Courier
Determined by total footings (balances) with the bank.	Top 50 customers by turnover	Based on profitability	Account revenue size or potential

Table 14.3 How High Value Customers are Determined

Another factor which flows from the differences in the application of customer profitability analysis information is that the firms rely on different information for price negotiation (Storbacka 1993, Booth 1994, Hudson 1994), cross selling (Petro 1990, Storbacka 1993, Morris 1994, Hartfeil 1996, Kirby 1996, McCormick et al 1996) segmentation (Petro 1990, McCormick et al 1996, “Profiting” 1996, Berry & Britney 1996), managing the customer relationship (Howell & Soucy 1990, Storbacka 1993, Booth 1994, Smith & Dikolli 1995, Hartfeil 1996, Jeffrey & Franco 1996, “Profiting” 1996, Bellis–Jones, 1989) and targeting new customers based on these characteristics. The firms’ approach to these techniques is shown in Table 14.4.

Marketing Technique	Bank	Manufacturing	Energy	Courier
Price Negotiation	Using customer profitability analysis information	Based on revenue for our Top 50 customers Strong brands allows a price premium - use brand profitability; Shelf space profitability	For individual business customers we using customer profitability analysis information	Contract rate is set by the account manager based on a product margin model
Cross Selling	As above	As above	Product and customer profitability information	Pricing model
Segmentation	Revenue information at the strategic level Customer profitability information at the operational level	As above	Customer profitability information	Account potential and account size
Managing the Customer Relationship	Customer profitability analysis model is used by an operational manager to manage particular customer groups	Revenue based working closely with the Top 50 to improve profitability of the firm's business and stock turnover	Profitability information particularly for business customers	As above

Table 14.4 Information Used to Support Marketing Techniques

Stuchfield and Weber (1992) and Foster and Gupta (1994) suggested that information from a customer profitability analysis system could help firms understand the relationship between a retention strategy and firm profitability, yet there is no empirical evidence to date which supports this view. Interviewees were asked if customer profitability analysis information helped the firm understand the relationship between firm profitability and customer retention. The responses are presented in Table 14.5.

Bank	Manufacturing	Energy	Courier
Does not help in understanding this relationship The model cannot aggregate customer profits with total corporate profits	May help in understanding this relationship. All customers are retained New business rarely turned away	We can identify the profitability by individual customer group - equivalent to product groups as the largest cost is the cost of the energy provided	No - this relationship can be shown and explained through historical sales patterns

Table 14.5 Does Customer Profitability Analysis Information Help the Firm Understand the Relationship Between Retention and Firm Profitability?

Summarising these responses, for the bank the customer profitability model does not help understand the relationship between retention and firm profitability; for the energy firm it can help as total firm profits can be broken down into customer groupings; the courier firm believes revenue information is sufficient to gain an understanding of this relationship, and for manufacturing it is perceived that this type of information may help, and a model is being planned.

Chapter Summary

This chapter has provided a description of the customer profitability analysis systems in place. It also has detailed the interviewees' perception of the relationship between following a customer retention strategy and firm profitability. How these firms view the role of customer profitability analysis information in understanding that relationship has also been depicted.

All respondents, bar one, believed that it is difficult to relate accounting numbers to customer retention and loyalty. These results are consistent with Ittner and Larcker (1996).

In regard to the relationship between following a retention strategy and firm profitability, interviewees provided a mixture of responses. Different industries appear to view the relationship differently. The energy firm is convinced of the relationship, while the bank, courier and manufacturing firms feel that this relationship is mitigated by other factors.

The interviewees' responses to the relationship between retention and other strategies, were reinforced by a comparison with firm performance. All firms have achieved performance outcomes using a customer retention strategy to varying degrees.

Finally, the cross-site responses to the use of customer profitability analysis information in understanding the relationship between customer retention and firm profitability were presented. Again, mixed responses were provided, but the firm which followed customer retention as the dominant strategy believed that the relationship was better understood with information provided from such a system, subject to the system's limitations.

Having provided the evidence in chapters seven through ten, and the cross-site analysis in chapters twelve and thirteen, this research now seeks to provide an explanation for the variability that has arisen. Ryan et al (1992, 124) state that: "If existing theories conflict with the patterns observed in the case it will be necessary to collect evidence in order to ascertain explanations for these conflicts [so that] theories can be extended to meet the new circumstances."

I have found in the first phase of this thesis, that firms following a customer retention strategy do not necessarily have a CPA system in place to support the strategy. Therefore what has been prescribed in the literature is not occurring in practice.

As stated in chapter two it was anticipated that this strategy-cost system alignment would be contingently based. As a result in the next chapter, a contingent based analysis is presented which provides the opportunity for an extension of the existing theory on the relationship between customer retention and customer profitability analysis. In addition, the existing contingent based management accounting literature is updated through the examination of new strategy-structure paradigms.

Through further (email) dialogue with the existing sites, additional evidence from two more sites and a marketing consultancy firm⁹³, contingent factors were identified as affecting the CR/CPA link. These factors lead to propositions developed and tested in chapter fourteen.

⁹³ The proposition in relation to organisation size came from the existing literature.

Chapter Thirteen: Customer Retention and Customer Profitability Analysis: The Contingent Explanation

Introduction

Chapters seven through twelve have provided the evidence and the cross-site analysis of the four firms studied. Initially, from the literature presented in chapters three to five, it had been inferred that a firm would most likely follow a customer retention strategy, given the changing nature of the focus of business from a production orientation to a customer orientation. Further, if a firm were to follow a customer retention strategy, then it should focus this strategy on the most “profitable” customers. To do this a customer profitability analysis system would be in place to support that strategy. However, this research has shown that this prescribed strategy-information system relationship does not exist in all real world business contexts. The examination of extant practice at these four firms shows some similarities, but also deviations from the theoretical recommendations presented.

As was stated in chapter two, inconsistency of observed practice with theoretical recommendation can be explained using contingency theory. The purpose of this chapter is to present a contingent analysis of the strategy-cost system relationships that have been identified at the four sites. This analysis is important as there has been no contingent based analysis undertaken in the customer profitability-customer retention field. The impacting contingent factors are discussed, including those already examined in the management accounting contingency literature in relation to alternative strategy-structure paradigms and factors previously not examined (Fisher 1995). Finally, as was

stated in chapter six, the opportunity for additional evidence arose. This additional evidence is used to add further support to the contingent analysis.

The Contingent Examination of the Strategy-Cost System Interface

Strategy Selection

Not all firms in this research were committed to a retention strategy to the same degree. Thus it appears that the type of industry is a contingent factor affecting the selection of this strategy. The energy firm was facing a situation of dramatic change. *“The imminent split of [the firm] into energy and line businesses, and the expected sale of the energy business”* affected the selection of the retention strategy greatly. At the time the original interviews were undertaken, the firm had been following a customer retention strategy for two years. The purpose of *“single mindedly”* following the customer retention strategy was that the firm knew, without doubt, that when deregulation arrived they would lose customers.⁹⁴

Right now we have 100% [of all possible customers]. However, with the changes in the electricity industry following the Electricity Reform Legislation this year [1998], the energy business (selling electricity) is being sold, and the line business will end up with very limited customers.

The energy business would now have to provide the electricity service in direct competition with many other suppliers now allowed to enter the market.

⁹⁴ Later in 1988, after the split occurred, the firm dedicated whole page advertisements in local newspapers expressing the advantages of staying with the original supplier.

Carroll (1992) criticised the recommendation that firms follow a customer retention strategy. He argues it was being offered as a cure-all for firm profitability but that this is illogical:

“Retention is a nice tactic, not a grand strategy...If all U.S. retail bank customers, without prompting, suddenly decided to change banks a bit less often, would industrywide profitability nearly double? The retention argument says so, but does this sound unreasonable? Would revenues rise? No. Would costs decline? Only marginally. Yet, retail bankers are offered customer retention as if it were their salvation, the newly discovered center of their universe.” (Carroll 1991-1992, 25)

Much of the literature on customer retention has been written about the banking industry but the bank in this research agreed with Carroll (1991-1992) that customer retention alone was not sufficient. Interviewees had witnessed their competitors spending *“a great deal of money on customer retention and consistently under perform profit wise.”* Interviewees thought that success (profit wise) was more likely to be achieved with a balance between acquisition and retention of customers as well as driving profit throughout the business.

The manufacturing firm clearly shows that strategy selection is contingent on industry type:

Our situation with customer retention is different than other companies. The low value nature of our products means it is not really worth developing a relationship with consumers. We drive our marketing on a brand basis. [Customers] don't tend to switch from us to competitors as may be the case with banks.

This firm was also functioning in an industry which had changed:

...greatly in the last five years. [The market was] declining [and in this] difficult retailing environment [there was also] reduction in government tariffs and increasing [cheaper] imports.

With many manufacturers closing or moving offshore due to tariff reductions, we see delivery performance and ability to deliver new initiatives quickly as an offset to some of the current price-driven mentality. We have shared this vision with our major retailers.

We are in an industry that is under huge pressure from reducing tariffs and the proliferation of imports. We have a strategy [brand awareness-customer loyalty] that we feel best responds to our changing environment.

The courier firm takes a similar approach to the manufacturing firm. The dominant strategy was to be the:

pre-eminent courier brand in New Zealand by the year 2000. [This] milestone was achieved some 14 months ahead of time. Strategies, such as customer retention stem from this overall strategy as it is obviously key in achieving a number one position.

Further evidence for the effect of industry type on strategy selection is provided by the primary industry site:

The nature of this company is that we sell to two main customers who then on sell products. 95% of product is exported under statutory law requirements. As such we focus on the manufacturing arm, leaving much of the marketing tasks to the board.

Because of the type of industry a customer retention strategy is followed “informally.”

We like to keep our customers happy in terms of product quality and on time delivery. In our commodity based business everything is hooked in some manner to commodity prices. The main way we can make money above the price of the commodity is to make specialised products that have a specific return and we try and retain these customers. The purchase of a wider line of company products by our long time customers results in economies of scale – but some times long term business to long term customers can be the least profitable. We drive profitability through cost reduction and high-value-added products.

The above analysis provides evidence that customer retention is not necessarily the applicable dominant strategies for all industries. Clearly strategy selection is influenced by political reform (Anderson and Lanen 1999); by the competitive environment and by

the nature of the product or service sold. Clearly where “branding” is possible this impacts on the retention strategy.

Cost System Selection⁹⁵

Anderson and Lanen (1999) showed that competitive strategy, economic and political upheavals and international outlook were important contingent factors in explaining the differences in management accounting practices. Earlier, Young and Selto (1991, 276) suggested that issues such as “market dominance...combinations of market power (oligopoly) uncertainty, and product growth can lead to optimal, strategic costing systems”, yet these have not been examined. The energy firm illustrates these influences.

The energy firm adopted the customer retention strategy because of a political change which deregulated the electricity industry. Within this new competitive environment customer retention dominated the strategic outlook. As a result the firm aligned a customer profitability analysis system with the strategy. Yet this apparent strategy-cost system fit is simplified by the nature of the industry. For this firm customer profitability analysis is not vastly different from product profitability analysis:

For electricity we simply take the likely quantities of energy sold across different products: combine them to provide total revenue and compare them with the anticipated purchases we need to make on the wholesale energy market. Indirect administration and related costs are minimal compared with energy purchases.

⁹⁵ Bruns and Waterhouse (1975) and Merchant (1981) showed that size is positively related with accounting sophistication. The four original sites are large organisations, yet only two had CPA in place. Size will form the basis of one of the propositions tested in chapter fourteen.

We perform product profitability analysis really given the fact we have 150,000 customers!

The customer groups that [the model] is referring to are in reality our product [tariff] types. Total revenue can be quite easily determined for the group but in terms of profitability even at gross margin level we need...to make [many] assumptions To take it to a net contribution we then need to allocate costs – more estimation.

Because of the relative ease with which this firm could calculate customer profitability, information from the system was used to examine the impact of the retention strategy on profitability. Total corporate profit could be broken down into customer/product profits.

The primary industry is in a similar situation. Because of market dominance, and because the commodity price is the largest cost, the firm uses:

...product cost, delivery cost and finance cost information which results from product stream analysis to support the marketing strategy. Product costs and standard costs developed for the industry as a whole are used for price negotiation.

The bank did have a customer profitability analysis system in place but it did not help the firm understand the relationship between the strategy and profitability. Contingent factors affecting this strategy-cost system alignment were clearly evident. Firstly, as discussed in detail in chapter eight, the bank found it extremely difficult to attribute all costs to customers. The variety of customer costs in the banking industry was evidenced in the literature provided in chapter three.

Secondly, because the model was employed at a business unit level, total corporate profits and customer profits “do not add up.”

Thirdly, as customer profitability analysis is a new idea or an accounting innovation its implementation needs a “champion” (Firth 1996). The champions at this site were

members from an operational level of the company – namely business managers: *“The prime movers behind the model are finance and the business banking area. The system was designed due to requests for profitability information by business unit managers. It was agreed that the model would be produced jointly by head office finance and the managers.”* Senior marketing executives – the strategy makers – *“were not interested”* *They use their own models – revenue information. ”*

Jassawalla and Sashittal (1999) note the emergence of cross-functional teams as popular structural solutions in relation to new product development. Johnson (1992) also discusses the importance of teamwork and how this has changed management accounting. A contingent factor that influences the adoption of customer profitability analysis information at some of the sites investigated here is the relationship between the marketing and accounting functions. Many factors mitigate the success of this marketing and management accounting cohesion.

An extensive interview with the director of a marketing agency, which dealt *“with at least forty companies covering a range of industries and sizes,”* was undertaken to discuss the concept of marketing and accounting cohesion and how this may impact on strategy-cost system alignment. The marketing agency was attempting to implement with its clients a *“Recency, Frequency, Monetary Value Model”* to be associated with individual customers. Monetary value is based on gross sales and profits. The marketing agency’s biggest obstacle to implementation of this lifetime value concept has been the difficulty of getting the marketing and finance functions to work together.

The interviewee saw a number of issues which affected this relationship. Firstly, marketing staff views accounting staff with suspicion. The interviewee commented:

I could go and have lunch with a group of marketing personnel and mention the importance of profit. The marketing personnel would say, oh so you want us to be controlled by those bean counters! All they want to do is cut our budgets. They have no idea about the market. Anyway all that matters is sales volume! Big clients who spend a lot are what we need. They must be making money if they buy a lot.

Conversely:

If I went and had lunch with a group of finance people and mentioned marketing, the negative response would be equally as bad. The accountants always say – oh marketing people. They like fancy cars, they like to spend money – they only care about selling! And big budgets. They have no respect for return on investment or profits. When we try and give them relevant information they do not want to discuss it.

Interviewees at the other sites, in both marketing and accounting, believed that it was important that marketing staff understood the cost impact of marketing decisions. Yet this interviewee felt, that until financial management became part of the marketing function – “*there should be no distinction*” – it would be difficult for firms to focus their marketing strategy on relevant management accounting information. We discussed possible solutions. He suggested that the education process had a lot to do with it. He felt that marketing staff had an extremely limited financial knowledge, and that equally, accounting staff were “*anti marketing*”. He thought it important that both marketing and accounting, (and production) should attend ongoing seminars and training in each other’s functional areas⁹⁶, to ensure the “*team concept*” could be fully implemented⁹⁷.

⁹⁶ An analysis of the data at one New Zealand university shows that in the 3 year period 1995 – 1997, 27%, 37% and 28% of management accounting students respectively, enrolled in a marketing course. This percentage may need to be increased if the marketing-management accounting interface is to improve.

⁹⁷ This lack of cohesion between marketing and finance was demonstrated in an attempt to gain access to another company. The initial conversation was with the marketing personnel and they agreed to participate. They also took the responsibility of organising a member of the finance department to participate. After considerable attempts, the marketing manager stated he

Other interviewees concur with this view. The following comments were typical:

Accounting and marketing do not really interact well in our organisation. We generally work on an adhoc basis.

I [finance] do not have sufficient knowledge of marketing to provide marketing with what they need.

I [marketing] do not know if I have enough knowledge to ask accounting for what I need

I don't know if I know enough to know!

I believe that management accounting could provide marketing staff with information but a lot of work would need to be done on systems etc to get it accurately and timely.

On reflection we could probably do it better – [interaction of marketing and accounting].

The interaction is largely one way, with accounting providing cost information re projects. The value returned on the spend was not quantified. Improved interaction could have occurred with an improved appreciation of this cost/value relationship.

Firth (1996) states that one of the reasons why an accounting innovation may not be adopted is that the organisation lacks the existing labor skills to implement the innovation. The manufacturing firm was in this situation. “*We do not have it yet but we are intending to look at it.*” At the courier firm, the lack of the necessary labour skills was more evident. “*We use a pricing model to help answer marketing issues. This is currently under review and the adoption of activity based costing is our next option.*” The fact that the bank and the energy firm were much larger businesses than the other two no doubt impacts on resource availability.

had been unable to get one of the finance personnel to cooperate, adding that the two departments did not often interact, and tended not to be supportive of each other.

Multiple Strategies and Control Systems

Bruggeman and Van der Stede (1993, 206) state: “If combination strategies are successful and if control systems should fit the strategy, then management controllers should also design appropriate control systems to support these strategies. Not much is known in this area.” The sites researched here offer some excellent examples of multiple strategies and cost system fit. Note that Anderson and Lanen (1999) stated that there had been little research examining the relationship between strategy and cost systems. The predominance in the literature had been on management control and performance evaluation.

At the bank, there were three strategies: acquisition, profit driving and customer retention. To support the profit driving strategy the firm has implemented an activity based costing system as part of a drive for cost management: “*Activity cost information is being used to minimise activity costs. This lies in the realm of cost management which is being addressed at the bank*”. For the customer retention strategy the firm does use the customer profitability analysis system at an operational level in an attempt to make “*customers profitable*.” At a strategic level however, revenue analysis dominates.⁹⁸

At the manufacturing firm, the dominant strategy is brand awareness. They do believe however that customer retention flows from this strategy. For this firm the cost systems used to support the strategy are product profitability and shelf space profitability:

⁹⁸ Shortly we will consider the issue of whether control systems are complementary or substitutable (Fisher 1995).

We drive our marketing on a brand basis, thus we look at brand profitability rather than customer profitability. We also do an analysis of shelf space profitability, particularly in supermarkets. Shelf space allocation to our brands is based on profitability for the area we take up. We are continually analysing this against our competitors and other supermarket categories. For instance, our shelf space for [our product] in supermarkets will likely come under pressure when beer sales are available in supermarkets. Repackaging to reduce space and other areas need to be looked at.

Substitutability of Control Systems

Fisher (1995) states that future research should examine the conditions under which control systems are complementary or substitutable. In chapter four, it was recommended that firms rely on customer profitability analysis information to support their retention strategy yet firms here are substituting the management accounting information used to support the strategy, particularly with customer revenue information only. Three of the four firms studied here categorise best customers based on customer revenue.

All four companies are following a customer retention strategy, albeit to varying degrees, yet all four firms utilise different management accounting systems. The bank utilises a second-generation customer profitability analysis system but this is used at an operational level by business managers. The main thrust of the customer profitability model is pricing – not cost management. At the strategic level of the retention strategy the marketing department bases retention calculation on revenue or volume.

For the manufacturing firm it was felt that customer profitability did not fit well with the firm's strategy. The firm substituted customer profitability information with customer sales revenue information. Because they focus on brands management accounting information is provided to fit with the business strategy. The firm does not have a customer profitability analysis system, and although accepting that such

information might be useful, top 50 customers were determined based on sales revenue, and in some isolated cases, gross margin. Interviewees at the courier firm also believed that “*historical sales pattern*” information was sufficient to support a retention strategy.

In summary then, for the manufacturing firm, courier firm and the bank, where there is a customer profitability analysis system in place, it appears that customer revenue information is substitutable for customer profitability information to support a customer retention strategy. It is also important to note that all firms in this study were achieving the desired performance outcomes.

Further support for the substitutability view is provided by the entertainment company. For this firm the majority of revenue is sourced from advertising. This firm follows a customer retention and customer acquisition strategy. Three types of customers are classified. Forty percent of revenue comes from advertisers who are members of an advertising club. The club provides commercials at cheaper rates to suit the “*entertainment company’s requirements*”. Thirty percent of inventory is sold for national advertising and “*they control the costs of those ads.*”. The remaining thirty-percent of revenue is from casual buyers including the “*top 15 clients.*”

In lengthy personal interviews with the chief executive officer [an accountant by professional training] and the sales manager, the issue of customer profitability analysis information was discussed. Both interviewees believed that such a system was not applicable in this industry. “*70% of costs are fixed regardless of revenue. We only have 30% of overheads and so what matters to us is revenue. Every dollar generated contributes to those fixed costs and overheads.*” It was believed that customer cost variability did not warrant separate analysis.

Fisher (1995) states the contingent control literature is based on the premise that a correct match between contingent factors and the firm's control package will result in performance. Yet there had been no studies which linked marketing strategy with cost management systems and firm performance. For the four firms here the results are interesting. All four firms follow some similarities in strategy: the bank – retention, profit driving, and acquisition; the manufacturing firm brand-awareness (linked to customer loyalty); the energy firm – customer retention; and the courier firm – brand leadership (linked to loyalty). All four firms have been profitable over the two years 1996 and 1997. Yet all rely on different information. The bank relies on customer revenue information (and customer profitability information at the operational level); the manufacturing firm relies on brand profitability, shelf space profitability and customer revenue; the energy firm relies on customer profitability information (which is equivalent to product profitability information as product cost is the dominant cost and there is minimal indirect and administration costs); the courier firm relies on a pricing model to support marketing decisions but this *“is currently under review.”* Revenue information dominates the analysis.

Therefore, what appears important is that there be alignment between the strategy in place and the management accounting system supporting that strategy. For example, in this research the manufacturing firm was following a brand loyalty strategy, so therefore the management accounting system offered information on brand profitability and shelf space profitability. For the courier company brand leadership was the target, management accounting information was revenue driven. If market share is sought, revenue information appears to be sufficient to support the strategy. In these cases the strategy and the management accounting systems “fit”.

Conclusion

The relationship between customer retention and customer profitability analysis has now been examined using a contingent approach. It has found that not all firms follow a customer retention strategy as the dominant strategy and it is industry dependent. Level of competition and changing political environments impact on that decision.

Secondly, not all firms may have a customer profitability analysis system to support the customer retention strategy. Many factors impact on the implementation of customer profitability analysis systems. These include product and hence cost complexity; the relationship between the marketing and accounting functions; who champions the system and whether there are the labour resources available for the implementation. Yet three of the firms studied here have been successfully following a retention strategy relying on alternative management accounting information, namely customer revenue information. This evidence provides support for Fisher (1995) that management accounting systems are substitutable and firms can still achieve desired performance outcomes. What appears important is strategy-cost system alignment.

As a result of the qualitative analysis presented in chapters seven through thirteen, the following propositions have been developed which will be tested for support. The propositions are:

1. CPA will be used by firms which view a CR strategy as important
2. CPA usage is higher in larger companies
3. There is significant cross industry variation in CPA adoption
4. CPA non-adoption is influenced by the seven factors identified in the qualitative evidence; and size and industry type. The seven factors are:
 - a) It is difficult to determine customer revenue
 - b) It is difficult to determine customer cost
 - c) The firm does not have a champion for accounting innovations

- d) Marketing staff did not CPA
 - e) Accounting and Marketing do not work well together
 - f) The firm does not have the existing labour skills to implement the system
 - g) Customer revenue is sufficient
5. Satisfaction with accounting systems to support marketing strategy is higher in CPA users.

We now turn to chapter fifteen which presents the survey analysis.

Chapter Fourteen: Survey Analysis

Introduction

As stated in the introduction the objectives of this research were to:

- ◆ To identify company perceptions of the level of importance of a Customer Retention Strategy
- ◆ To attain insights into CPA adoption rates
- ◆ To identify some of the contingent factors that might affect CPA adoption rates
- ◆ To gain some perspective on the extent to which marketing managers are satisfied with the management accounting support for the operational marketing strategies.

In stage one of the thesis, a prescriptive analysis was presented. It was recommended that a firm should follow a customer retention strategy and that the strategy should be supported by a customer profitability analysis system. It has also been stated that a firm could use CPA information to understand the relationship between a CR strategy and firm profitability. Yet the qualitative evidence did not support this prescription.

As a result of the initial evidence, and the existing contingency based strategy/structure literature, a theory on the relationship between marketing strategy at the operational level and the use of specific accounting techniques was considered. In particular, it seemed that, either the selection of marketing strategy was industry dependent or that a firm would follow more than one operational marketing strategy. Further, specific accounting techniques to support the marketing strategy differed. For example, although each firm followed a customer retention strategy, albeit it to varying degrees, not all firms used customer profitability analysis to support the strategy, as was prescribed in the literature. Several factors impacted on the specific use of customer profitability analysis to support the firm's marketing strategy. The factors included:

1. The level of difficulty associated with determining customer revenues
2. The level of difficulty associated with determining customer costs
3. Whether the firm has a champion for accounting innovations⁹⁹
4. Whether marketing staff asked for this type of information
5. Whether accounting and marketing staff worked well together
6. Whether the firm had the existing labour skills to implement a customer profitability analysis system

Given that the literature had prescribed that customer profitability analysis should be used to support a customer retention strategy, and that the initial qualitative evidence had been contrary to this, it was seen as important to consider the level of satisfaction with current accounting systems in a wider audience; in the initial sites, customer revenue information was seen as sufficient to support the marketing strategy in three of the four sites.

Given these contradictory findings the second stage of this thesis sought to explore the extent to which the propositions, developed at the end of the last chapter, are supported. This chapter discusses those findings. The chapter provides descriptive statistics to all the survey responses and tests the five propositions using a variety of statistical techniques.

The Survey

Response Rates

As stated in chapter seven, a survey was sent to both the marketing manager and the accounting manager in 431 organisations. Three mailings were used: an initial and two follow-ups. Two data bases were used, namely UBD (sample of 314 companies) and

Datex (sample of 147 companies). A pleasing result is that both the marketing and accounting response rates are very similar between both databases.

The initial response rates achieved from the first mailing are shown in Table 14.1.

Functional Position	Source of Sample	Useable	% of Sample	Non-useable ¹⁰⁰	% of sample
Accounting	UBD	79	9.16%	14	1.62%
	Datex	42	4.87%	16	1.86%
Marketing	UBD	75	8.70%	6	0.70%
	Datex	39	4.52%	11	1.28%
Total	UBD & Datex	235	27.26%	47	5.45%

Table 14.1: Initial Response Rates from First Mailing

The first follow-up was sent three weeks after the initial mailout and included another copy of the questionnaire. The response rates, which resulted from the second follow up, are shown in Table 14.2¹⁰¹.

⁹⁹ As customer profitability analysis system is considered to be an accounting innovation

¹⁰⁰ Non-useable surveys were returned but were not completed.

¹⁰¹ Where a firm response is required both marketing and accounting responses are included. Where a user view is required only marketing responses are utilised.

Functional Position	Source of Sample	Useable	% of Sample	Non-useable	% of sample
Accounting	UBD	46	5.34%	9	1.04%
	Datex	19	2.20%	5	0.58%
Marketing	UBD	55	6.38%	12	1.39%
	Datex	13	1.51%	5	0.58%
Total	UBD & Datex	133	15.43%	31	3.60%

Table 14.2: Response Rates Achieved from the Second Mailing

The second follow-up was sent three weeks after the first follow-up. It was a letter asking non-respondents to indicate on a “non-response sheet” why they had not completed the questionnaire (See Appendix Six). As a result of the second follow-up, an additional 11 questionnaires were received. One hundred and fifty non-response sheets were also returned. The final response rate was 70.42% with a useable response rate of 43.97%. As “mail surveys with a return of about 30 percent are often considered satisfactory...”(Cooper and Emory 1995, 282), this response rate is, without question, acceptable for undertaking the necessary statistical analysis. The overall response rates are shown in Table 14.3.

Functional Position	Source of Sample	Useable	% of Sample	Non-useable	% sample	Non – response sheet	% of sample	Total as % of sample
Accounting	UBD	130	15.08%	23	2.67%	65	7.54%	25.29%
	Datex	62	7.19%	21	2.44%	10	1.16%	10.79%
	UBD & Datex	192	22.27%	44	5.11%	75	8.70%	36.08%
Marketing	UBD	133	15.43%	18	2.09%	56	6.50%	24.01%
	Datex	54	6.26%	16	1.86%	19	2.20%	10.32%
	UBD & Datex	187	21.69%	34	3.95%	75	8.70%	34.34%
Total	UBD & Datex	379	43.97%	78	9.05%	150	17.40%	70.42%

Table 14.3: Overall Response Rate

The reasons for the 228 non-useable responses (78 + 150 – see Table 14.3) are summarised in Table 14.4.

Functional Position	Source of Sample	Not Useable	Not applicable	Standard Policy of Not completing Questionnaires	No time	Wrong Address	Other ¹⁰²
Accounting	UBD	9	37	14	18	4	6
	Datex	0	15	2	1	10	3
Marketing	UBD	2	30	11	16	7	8
	Datex	0	19	1	5	6	4
All	Total	11	101	28	40	27	21

Table 14.4: Reasons for Non-response

Non-Response Bias

A two-tailed *t* test was carried out as a test for non-response bias. Early responses (first mail out) were compared with late responses (second mail out) on five important questions. The test was based on Mirani and Lederer (1998) and the results are shown in Table 14.5.

¹⁰² A range of reasons was given in other. But one in particular caught my sense of humour: "Neo-classical economics is not only wrong, it is sending human civilisation to the wall. a) You can not substitute for food, water and energy. b) Continuous growth is impossible on this planet, (breaking news the earth is round/spherical thus finite). The limits to growth are fast approaching (Global crude oil production will peak within the decade) and the system we use for every decision (economics) is not capable of 1) obtaining the information & 2) acting according to a species/world goal. Hence no reply!"

Question	1 st Mailing Mean n =	2 nd Mailing Mean n =	t-value	p
Importance of customer retention	4.806897 n = 233	4.806867 n= 145	0.000511	0.99
Importance of customer profitability analysis	4.214286 n = 224	4.181818 n=143	0.305006	0.76
Satisfaction with accounting systems to support marketing strategy	3.339056 n=233	3.510345 n=145	-1.663186	0.09
It is difficult to determine customer costs	3.602041 n=98	3.328358 n=67	1.452594	0.15
Customer revenue information is sufficient	3.390625 n=64	3.323077 n=65	0.298694	0.76

Table 14.5: Non-response Bias Analysis

These comparisons reveal only one marginally significant difference at the 10% level between early and late respondents.¹⁰³ This result, coupled with the high response rate, diminishes the possibility of the presence of non-response bias.

¹⁰³ This relates to the level of satisfaction with accounting systems. This result is discussed in more detail later when we examine the levels of satisfaction of users and non-users of customer profitability analysis.

Survey Analysis

Industry Type

The first question in the survey, a copy of which is provided in Appendix Three, sought to establish the industry type of the organisations. Industry type is shown in Table 14.6.

Industry Type	Number of Respondent Organisations	% of Respondent Organisations ¹⁰⁴
Agriculture, Forestry and Fishing	26	6.86%
Mining	2	0.53%
Manufacturing	95	25.07%
Electricity, Gas and Water Supply	11	2.90%
Construction	20	5.28%
Wholesale Trade	27	7.12%
Retail Trade	42	11.08%
Accommodation, Café and Restaurants	12	3.17%
Transport and Storage	28	7.39%
Communication Services	14	3.69%
Finance and Insurance	21	5.54%
Property ad Business Services	52	13.72%
Cultural and Recreational Services	13	3.43%
Personal and Other Services	12	3.17%
Other:	4	1.06%

Table 14.6: Industry Type

In the case studies, industry type was seen as important in influencing strategy selection and cost system implementation. As a result the survey sought to get a wide range of industries in the sample. Table 14.6 shows that many different industries are represented; and the analysis later in this chapter will examine industry influences.

¹⁰⁴ Percentages relate to the number of usable responses.

Organisational Size

Merchant (1981) and Bruns and Waterhouse (1975) argue that organisational size influences accounting sophistication. As customer profitability analysis can be classed as an accounting innovation, a range of organisational sizes were sought in the sample, as shown in Table 14.7. Analysis later in this chapter will examine both industry type and organisational size influences.

Number of Employees	Number of Organisations	% of organisations ¹⁰⁵
Zero	5	1.32%
1-10	45	11.87%
11-20	74	19.53%
21-30	38	10.03%
31-50	36	9.50%
51-100	22	5.80%
101-200	37	9.76%
201-300	24	6.33%
301-400	7	1.85%
401-500	9	2.37%
>500	82	21.64%

Table 14.7: Number of Employees as an Indicator of Organisational Size

Marketing Strategies

Question three sought to establish the importance of operational marketing strategies in the firms under investigation. There were three strategies listed, namely customer retention, customer acquisition and brand leadership. These categories were developed from the evidence collected in the case studies. There was also an “other” option provided. The respondents were asked to rank the importance of the strategy to their firms on a Likert Scale with a 1 signalling the strategy was not important and a 5

indicating the strategy was very important. The results of the ranking on strategy are shown in Table 14.8.

Strategy	Mean	SD
Customer Retention	4.81	0.028
Customer Acquisition	4.35	0.042
Brand Leadership	3.98	0.056
Other ¹⁰⁶	4.81	0.07

Table 14.8: Ranking of Importance of Operational Marketing Strategies

All but a few respondents ranked all the three operational strategies as very important, with customer retention producing the highest mean score. These results add further support to the evidence collected from the qualitative studies where it was shown that multiple strategies were possible.

However, these results do not support the findings which stated that marketing strategy selection, in particular in relation to customer retention, was industry dependent. As shown in Table 14.6 a range of industries were covered and all rank customer retention very highly. The five lower importance rankings were given by firms in agriculture, transport and storage, finance and insurance and property and business services, yet other respondents in these same industry categories ranked customer retention highly. Clearly all three operational marketing strategies are currently very important to New Zealand firms, with customer retention being the most important (mean score 4.81).

¹⁰⁵ Percentages relate to the number of usable responses.

¹⁰⁶ There were only 26 other strategies stated – 6.86% of sample. The strategies were: quality, word of mouth, customer service, price, business integrity, growth in revenue per customer, product leadership, sales process, e.business excellence, technical ability, active product development, client awareness of skills and customer confidence. Interestingly, many of these related to customers.

Accounting Information

Once the strategies had been identified, the questionnaire sought to establish what management accounting information was used to support those strategies. Based on the findings in the qualitative evidence, three types of information were suggested in the survey, with the opportunity for respondents to identify other types. Respondents were asked to place a yes response against the types of information used, and a no against those they did not use. The information used by the respondent firms is shown in Table 14.9.

Management Accounting Information	Number of Users	% of Respondents	Number of Non-Users	% of Respondents
Sales by Customer or Customer Group	309	81.53%	70	18.47%
Costs by Customer or Customer Group	177	46.70%	202	53.30%
Profitability (i.e. sales less costs) by customer or customer group	215	56.73%	164	43.27%
Other	12 ¹⁰⁷	3.88%	na	Na

Table 14.9: Types of Accounting Information Used to Support Marketing Strategies

Although the mean response for following a customer retention strategy was 4.81 in importance, only 57% of the respondents have a customer profitability analysis system in place to support the strategy. This result reflects the qualitative evidence and as a result, proposition one is not supported. CPA is not necessarily used by firms which view CR as important.

¹⁰⁷ The other categories mentioned by 12 respondents were profit by brand or marketing channel, sales by product, sales by area, profitability by product and job cost

In the case studies, it was argued that industry type may affect the decision of a firm to implement customer profitability analysis. To test whether industry type influences customer cost complexity, the non-users of customer profitability analysis were classified by industry type. The industry analysis is shown in Table 14.10.

Industry Type	Number of Non-users of customer profitability analysis	% of firms from this industry
Agriculture, Forestry and Fishing	15	58%
Mining	2	100%
Manufacturing	39	41%
Electricity, Gas and Water Supply	3	27%
Construction	11	55%
Wholesale Trade	8	30%
Retail Trade	26	62%
Accommodation, Café and Restaurants	6	50%
Transport and Storage	12	43%
Communication Services	8	57%
Finance and Insurance	9	43%
Property ad Business Services	13	25%
Cultural and Recreational Services	6	46%
Personal and Other Services	5	42%
Other	1	25%

Table 14.10: Industry Type Analysis of Non-Users of Customer Profitability Analysis

The descriptive statistics seem to provide support for the impact on industry type on CPA adoption. Some industry categories appear to be higher non-users: Agriculture, Forestry and Fishing; Mining; Construction; Retail Trade; Accommodation, Café and Restaurants and Communication Services. More than 50% of those from these industries do not use customer profitability analysis. Further, although comments were not elicited, some respondents stated that customer profitability analysis was not relevant to their industry; for example:

Costs are standard for each customer. [A wholesale group]

We have a unique situation where we have only four customers who utilise all our capacity.

We wholesale [oil and petroleum] to the few major oil marketing companies under processing contracts. The thrust of this questionnaire is largely irrelevant to our situation.

We use sales by brands. [Brand leadership rated 5 as well as customer retention being rated 5].

The business [transport and storage] has a very high fixed cost/asset structure therefore allocation of costs to individual customers is not helpful.

Production costs are basically the same for all customers and the differential is one of volume, therefore large customer purchases are more profitable than small customers. [Wholesale Plant Nursery].

However, proposition three, which stated that there is significant cross industry variation in CPA adoption could not be supported. To test his hypothesis the following regression equation was used:

$$Y = b_1 + b_2 + b_3 + b_4 + b_5 + b_6 + b_7 + b_8 + b_9 + b_{10} + b_{11} + b_{12} + b_{13} + b_{14} + b_{15} + b_{16}$$

Where:

Y = CPA adoption; dummy variable set equal to one (1) if adopted; otherwise zero (0).

b_1 = constant

b_2 = Agriculture, Forestry and Fishing; dummy variable set equal to one (1) if Agriculture, Forestry and Fishing, otherwise zero (0)

b_3 = Mining; dummy variable set equal to one (1) if Mining, otherwise zero (0)

b_4 = Manufacturing; dummy variable set equal to one (1) if Manufacturing, otherwise zero (0)

b_5 = Electricity, Gas and Water Supply; dummy variable set equal to one (1) if Electricity, Gas and Water Supply, otherwise zero (0)

b_6 = Construction; dummy variable set equal to one (1) if Construction, otherwise zero (0)

b_7 = Wholesale Trade; dummy variable set equal to one (1) if Wholesale Trade, otherwise zero (0)

b_8 = Retail Trade; dummy variable set equal to one (1) if Retail Trade, otherwise zero (0)

b_9 = Accommodation, Cafes and Restaurants ; dummy variable set equal to one (1) if Accommodation, Cafes and Restaurants, otherwise zero (0)

b_{10} = Transport and Storage; dummy variable set equal to one (1) if Transport and Storage, otherwise zero (0)

- b_{11} = Communication Services; dummy variable set equal to one (1) if Communication Services, otherwise zero (0)
 b_{12} = Finance and Insurance ; dummy variable set equal to one (1) if Finance and Insurance, otherwise zero (0)
 b_{13} = Property and Business Services; dummy variable set equal to one (1) if Property and Business Services, otherwise zero (0)
 b_{14} = Cultural and Recreational Services; dummy variable set equal to one (1) if Cultural and Recreational Services, otherwise zero (0)
 b_{15} = Personal and Other Services; dummy variable set equal to one (1) if Personal and Other Services, otherwise zero (0)
 b_{16} = Other; dummy variable set equal to one (1) if other, otherwise zero (0)

The regression results are presented in Table 14.11.

Industry Type	Coefficient	Significance
Agriculture, Forestry and Fishing	-0.8976	0.0466
Mininig	-5.4197	0.5702
Manufacturing	0.1749	0.4700
Electricity, Gas and Water Supply	0.7881	0.2500
Construction	-0.5610	0.2396
Wholesale Trade	0.6401	0.1444
Retail Trade	-0.8592	0.0123
Accommodation, Cafes and Restaurants	-0.4080	0.5070
Transport and Storage	-0.1431	0.7301
Communication Services	-0.5210	0.3440
Finance and Insurance	0.0788	0.8622
Property and Business Services	0.9840	0.0039
Cultural and Recreational Services	-0.0614	0.9137
Personal and Other Services	0.1273	0.8307
Other	0.8918	0.4416

Table 14.11: CPA adoption and Industry Type

There is negligible support for the proposition that there is significant cross industry variation in CPA adoption. CPA adoption is negatively significant for retail and agriculture, and positively significant for property and business services. The rest of the industry relationships are not significant.

Organisational size may influence the ability of organisations to implement accounting innovations as smaller firms may not have the available labour skills to implement innovations (Firth 1996). The non-users are classified by size in Table 14.12.

Organisation Size	Number of Non-users of customer profitability analysis	% of Non-users of customer profitability analysis	% of this Sized Organisation
0	5	3.05%	100%
1-10	20	12.20%	44%
11-20	37	22.56%	50%
21-30	19	11.59%	50%
31-50	20	12.20%	56%
51-100	7	4.27%	32%
101-200	13	7.93%	35%
201-300	11	6.71%	46%
301-400	1	0.61%	14%
401-500	6	3.66%	67%
>500	25	15.24%	30%

Table 14.12: Organisational Size analysis of Non-users of Customer Profitability Analysis

The descriptive statistics appear to indicate that organisational size does influence the ability of a firm to implement customer profitability analysis. Seventy-four percent of non-users were in firms of 100 employees or less. There were some exceptions to size. There was a high level of non-use in the 401-500 companies but there were only 9 in the sample. There was also a relatively high level of non-use in the 201-300 sized industries. Yet in the largest firms (>500 and 82 firms in total) the non-use drops to 30%. Also some comments were made by small companies which support this analysis:

Our problem is not lack of interest it is time and money.

[Customer profitability analysis] is not currently used. We realise we should be supplying that information to managers. We are behind in

the administrative function and it [customer profitability analysis] has been neglected.

Ignorant of the system [and circled “The firm does not have the existing labour skills to implement the system, in plumbing, 1-10 employees.”]

Proposition two stated that CPA usage is higher in larger companies. A binary logistic regression was used, expressed in the following equation:

$$Y = b_1 + b_2 + b_3 + b_4 + b_5 + b_6 + b_7 + b_8 + b_9 + b_{10} + b_{11} + b_{12}$$

Where:

Y = CPA adoption; dummy variable set equal to one (1) if adopted; otherwise zero (0).

b_1 = constant

b_2 = 0 employees; dummy variable set equal to one (1) if 0 employees, otherwise zero (0)

b_3 = 1-10 employees; dummy variable set equal to one (1) if 1-10 employees, otherwise zero (0)

b_4 = 11-20 employees; dummy variable set equal to one (1) if 11-20 employees, otherwise zero (0)

b_5 = 21-30 employees; dummy variable set equal to one (1) if 21-30 employees, otherwise zero (0)

b_6 = 31-50 employees; dummy variable set equal to one (1) if 31-50 employees, otherwise zero (0)

b_7 = 51-100 employees; dummy variable set equal to one (1) if 51-100 employees, otherwise zero (0)

b_8 = 101-200 employees; dummy variable set equal to one (1) if 101-200 employees, otherwise zero (0)

b_9 = 201-300 employees; dummy variable set equal to one (1) if 201-300 employees, otherwise zero (0)

b_{10} = 301-400 employees; dummy variable set equal to one (1) if 301-400 employees, otherwise zero (0)

b_{11} = 401-500 employees; dummy variable set equal to one (1) if 401-500 employees, otherwise zero (0)

b_{12} = >500 employees; dummy variable set equal to one (1) if >500 employees, otherwise zero (0)

The regression results are represented in Table 14.13.

Organisational Size	Coefficient	Significance
0 employees	-6.5124	0.5126
1-10 employees	-0.0663	0.8358
11-20 employees	-0.3511	0.1768
21-30 employees	-0.3134	0.3601
31-50 employees	-0.5586	0.1134
51-100 employees	0.5085	0.2793
101-200 employees	0.3662	0.3107
201-300 employees	-0.1223	0.7728
301-400 employees	0.5317	0.1580
401-500 employees	-0.9981	0.1621
>500 employees	0.7537	0.0051*

Table 14.13: CPA adoption and Organisational Size Regression Results

CPA adoption is only significant in firms larger than 500 employees, which provides support for the proposition that CPA adoption is higher in larger firms

Customer profitability analysis was described in detail in Chapter Four. Foster and Gupta (1994a) stated that more advanced systems of customer profitability analysis would incorporate the lifetime customer concept and cover all customer costs. As a result, the survey sought to establish which costs were allocated to customers if customer profitability analysis was used. Table 14.14 provides these results.

Cost Type	Number of Users	% of Users of customer profitability analysis	Number of Non-Users	% of Users of customer profitability analysis
Direct Customer Costs	195	90.70%	20	9.30%
Indirect Customer Costs	104	48.37%	111	51.63%
Lifetime Customer Costs	28	13.02%	187	86.98%
General Costs	100	46.51%	115	53.49%
Corporate Costs	57	26.64%	157	73.36%

Table 14.14: Costs Allocated to Customers

As can be seen a significant number of users of customer profitability analysis do not include lifetime costs (87% of users), corporate costs (74% of users) and only less than half use indirect (48% of users) and general costs (46% of users). The systems in place would predominantly represent first generation profitability analysis systems, which Foster and Gupta (1994a) criticise as being too simplistic. A respondent commented on the difficulty of calculating costs:

We would like to have more information on costs per customer group but it is impossible to obtain meaningfully.

Whether specific accounting information was used or not (Table 14.9), respondents were asked to state their perception of the level of importance of such information for supporting marketing strategy. These results are shown in Table 14.15.

Rank	1		5		Overall	
Accounting Information	<i>n</i>	%	<i>n</i>	%	Mean	SD
Sales by customer or customer group	9	2.40%	216	57.6%	4.41	0.86
Costs by customer or customer group	15	4.16%	122	33.8%	3.83	1.10
Profitability by customer or customer group	11	3%	179	48.77%	4.20	0.99
Other	0	0	4	50%	na	na

Table 14.15: Importance of Accounting Information Irrespective of Use

Both customer profitability analysis users and non-users see all three categories of information as important for undertaking their operational marketing strategies, with the largest mean score attributable to customer revenue information (4.41). The above result provides interesting opportunities for the development of accounting systems to measure customer costs and profitability as 54% of respondents did not use customer costs and 44% of users did not use customer profitability, yet the mean scores of importance are 3.83 and 4.20 respectively.

Reasons for Not Implementing Customer Profitability Analysis

As the literature had suggested that firms following a customer retention strategy should have a customer profitability analysis system in place, and the case studies had shown this not to be so, this survey sought to establish why firms did not have customer profitability analysis systems in place. This survey has already shown that size of the firm influences the decision by firms as to whether to implement customer profitability analysis. In addition, a range of influencing factors was identified from the case study research. These factors have received varying levels of support in the survey research. The results are shown in Table 14.16.

	1		5			
Factors influencing the decision to not have customer profitability analysis	<i>n</i>	%	<i>n</i>	%	Mean	SD
Difficult to determine customer revenues	50	33.33%	16	10.67%	2.65	1.42
Difficult to determine customer costs	17	10.69%	31	19.50%	3.52	1.18
No champion for accounting innovations	42	28.00%	14	9.33%	2.59	1.31
Marketing staff did not ask for it	49	34.03%	4	2.78%	2.33	1.17
Accounting and marketing do not work well together	45	30.61%	11	7.48%	2.49	1.27
Lack of existing labour skills to implement the system	45	30.00%	15	10.00%	2.59	1.34
Customer revenue information is sufficient	21	13.46%	35	22.44%	3.40	1.31
Other	0	0	15	100%	na	Na

Table 14.16: Factors Influencing the Decision to not have Customer Profitability Analysis

The two most important factors preventing a firm from using customer profitability analysis were difficulty in determining customer costs, and the belief that customer revenue is sufficient. Earlier the qualitative evidence and survey results support this factor. In Table 14.9, 82% of respondents used sales by customer group to support the firm's marketing strategies. Also customer sales information was the highest ranked in importance, whether used or not (4.41 in Table 14.15). Respondents commented:

Getting sales at a margin leads to more sales. Turning down sales on the basis of cost to acquire the customer loses customers and sales.

Sales by customer group is all we need.

Also the difficulties involved in determining customer costs are borne out in Table 14.14. Clearly there are difficulties in determining customer costs as Foster et al (1996) described.

The other factors which influence the decision not to have customer profitability analysis received lower mean scores yet are still seen as important on a scale of 1-5. Difficulty in determining customer revenues received a mean rating of 2.65, yet 54% of respondents gave it a ranking of 3, 4 or 5; No champion for accounting innovations received a mean score of 2.59 with 50% of respondents gave it a ranking of 3, 4 or 5. Similarly, marketing staff not asking for the information received a mean ranking of 2.33 yet 48% of respondents gave it a ranking of 3, 4 or 5. The relationship between accounting and marketing received a mean score of 2.49 with 50% of respondents giving the upper rankings. Finally lack of existing labour skills to implement the system received a mean ranking of 2.59, but 53% of respondents gave it the higher rankings. Mean scores can hide the fact that these reasons are significant for a number of respondents.

The “other” category was given to capture valuable information about other factors which may influence the decision of a firm not to have a customer profitability analysis system. Fifteen respondents gave other reasons. Eight of these said that customer profitability analysis was not relevant to their firms; five said they did not have the necessary information systems to undertake the analysis; one stated “*We are implementing it now*”; and one cited cost of implementation. There were also additional comments made in the surveys:

We will be moving to customer profitability analysis in the medium term.

Customer profitability is calculated to Gross Profit level only. Accounting information systems can always be improved but the cost versus benefit must be considered.

We are currently in a data mining exercise. It is only in the last 18 months that we have had access to point-of-sale technology that enabled us to collect customer information.

Our IT system is currently not up to the job without a lot of manual work. We could do it with spreadsheets.

Information systems can not provide information easily. The cost of getting that level of detailed information does not justify the benefits – this is the nature of our business.

Proposition four states that CPA non-adoption is influenced by seven factors. The seven factors are correlated along with size and industry. The significant correlations are presented in Tables 14.17 to 14.23.

Factor	<i>t</i> value	<i>p</i> value
Difficult to determine customer costs	0.218	0.012
Firm does not have an champion to implement accounting innovations	0.203	0.024
Accounting and Marketing do not work well together	0.322	0.000
The firm does not have the existing labour skills to implement the system	0.218	0.014
Construction Industry	0.206	0.018
Transport and Storage	-0.213	0.014
1-10 employees	0.332	0.000
21-30 employees	-0.207	0.017
31-50 employees	-0.191	0.028

Table 14.17 Correlations with: Difficulty in Determining Customer Revenue

Factor	<i>t</i> value	<i>p</i> value
Difficult to determine customer revenue	0.218	0.012
Firm does not have an champion to implement accounting innovations	0.265	0.002
The firm does not have the existing labour skills to implement the system	0.278	0.001
Retail Trade	0.168	0.045
11-20 employees	-0.180	0.032
>500 employees	-0.181	0.031

Table 14.18 Correlations with: Difficulty in Determining Customer Costs

Factor	<i>t</i> value	<i>p</i> value
Difficult to determine customer revenue	0.203	0.024
Difficult to determine customer costs	0.265	0.002
Marketing staff did not ask for it	0.331	0.000
Accounting and marketing do not work well together	0.434	0.000
The firm does not have the existing labour skills to implement the system	0.465	0.000
Customer Revenue is Sufficient	0.245	0.006
1-10 employees	0.221	0.012
11-20 employees	-0.186	0.035

Table 14.19 Correlations with: Firm does not have a Champion for Accounting Innovations.

Factor	<i>t</i> value	<i>p</i> value
The firm does not have a champion for accounting innovations	0.331	0.000
The firm does not have the existing labour skills to implement the system	0.367	0.000
Customer Revenue is Sufficient	0.198	0.028
Transport and Storage Industry	-0.207	0.020
21-30 employees	0.193	0.030
301-400 employees	0.185	0.038
>500 employees	-0.194	0.030

Table 14.20 Correlations with: Marketing Staff did not ask for Customer Profitability Analysis

Factor	<i>t</i> value	<i>p</i> value
Difficult to determine customer revenues	0.322	0.000
The firm does not have a champion for accounting innovations	0.434	0.000
The firm does not have the existing labour skills to implement the system	0.483	0.000
Construction	0.318	0.000
Transport and Storage	-0.227	0.010
Communication Services	0.183	0.038
>500 employees	-0.185	0.035

Table 14.21 Correlations with: Accounting and Marketing do not Work well Together

Factor	<i>t</i> value	<i>p</i> value
It is difficult to determine customer revenues	0.218	0.014
It is difficult to determine customer costs	0.278	0.001
The firm does not have a champion for accounting innovations	0.465	0.001
Marketing Staff did not ask for it	0.367	0.000
Accounting and Marketing do not work well together	0.483	0.000
Construction	0.212	0.015
Transport and Storage	-0.267	0.002

Table 14.22 Correlations with: The firm does not have the Existing Labour Skills to Implement the System

Factor	<i>t</i> value	<i>p</i> value
It is difficult to determine customer revenues	0.275	0.002
The firm does not have a champion for accounting innovations	0.245	0.006
Marketing Staff did not ask for it	0.198	0.028
Accounting and Marketing do not work well together	0.196	0.028
Construction	0.188	0.029
Transport and Storage	-0.247	0.004

Table 14.23 Correlations with: Customer Revenue Information is Sufficient

The correlations show that the difficulties associated with determining customer revenues and costs are associated with the accounting marketing interface. There also some size and industry factors, in particular the construction and transport and storage industries feature in many of the tables, therefore CPA non-adoption is influenced by the seven factors as determined in the qualitative part of this thesis.

Level of Satisfaction with Accounting Information

Respondents were asked to state their level of satisfaction with accounting systems to support the marketing strategy. For this analysis the users of accounting information – the marketing responses only, are used. These results are shown in Table 14.24.

Rank	Overall	
	Mean	SD
Level of Satisfaction with accounting information systems	3.40	1.044

Table 14.24: Level of Satisfaction with Accounting Systems

The mean rating for satisfaction was 3.40 for the total marketing sample. Non-user satisfaction was also analysed for any differences between users and non-users of customer profitability analysis; the results show a statistically significant difference between the two groups as shown in Table 14.25.

	Customer profitability analysis users Mean	Non customer profitability analysis users	<i>t</i> -value	<i>p</i>
Satisfaction with use of accounting systems to support marketing strategy	3.56 n = 106	3.18 n = 81	-2.361	0.0097

Table 14.25: Satisfaction with Use of Accounting systems: Non Customer Profitability Analysis Users versus Customer Profitability Analysis Users – Marketing Responses

Returning to the issue of non-response bias, the level of satisfaction with accounting systems was analysed for both early and late respondents, based on both customer profitability analysis users and non-users. These results are shown in Table 14.26.

	Customer profitability analysis users - early respondents	Customer profitability analysis users – late respondents	Customer profitability analysis non- users - early respondents	Customer profitability analysis non-users – late respondents
Level of Satisfaction Mean	3.49	3.68	3.11	3.49
t-value	-0.957		-1.811	
P value	0.1709		0.037	

Table 14.26: Satisfaction with Use of Accounting systems: Non Customer Profitability Analysis Users versus Customer Profitability Analysis Users - Early and Late Respondents

Late, non-user respondents, show a statistically significant higher level of satisfaction with their accounting systems to support their marketing strategies. This can be used to explain the issue of non-response bias. As they do not use customer profitability analysis, and are more satisfied with their accounting systems, they were less interested in completing a survey devoted to the use of this particular accounting system.

Proposition five states that satisfaction with accounting systems to support marketing strategy is higher is CPA users. To test this proposition, the following regression equation was used:

$$Y = b_1 + b_2 CPA$$

Where:

Y = satisfaction with accounting information to support marketing strategy – likert scale 1 not satisfied; 5 very satisfied.

b_1 = constant

b_2 = CPA adoption; dummy variable set equal to one (1) if adopted, otherwise zero (0)

The results are listed below in Table 14.27.

<i>Regression Statistics</i>	
Multiple R	0.176763927
R Square	0.031245486
Adjusted R Square	0.026008975
Standard Error	1.030304598
Observations	187

ANOVA

	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	6.333977959	6.333977959	5.966852078	0.015516639
Residual	185	196.3825996	1.061527565		
Total	186	202.7165775			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	3.185185185	0.114478289	27.82348707	5.044E-68
X Variable 1	0.371418588	0.152051602	2.44271408	0.015516639

Table 14.27: Regression Output for Satisfaction with Accounting System Support for Marketing Strategy for Customer Profitability Analysis Users.

Satisfaction with accounting systems to support marketing strategy is significant for CPA users, therefore proposition five is supported. It also supports the results shown in Table 14.23 above where satisfaction with accounting system use to support marketing strategy is significantly higher in CPA users than in non users.

Chapter Summary

This chapter has presented the results of the survey, which has completed the theory development-testing cycle. The qualitative evidence showed that the relationship between customer retention and customer profitability analysis was contingent. In chapter thirteen a theory of this contingent relationship was developed. This chapter has tested that theory and in the main the theory has been supported.

It was argued in chapter thirteen that strategy selection was industry dependent. More importantly, the original sites (apart from the electricity firm) followed more than one operational marketing strategy. These included customer retention, customer acquisition and brand leadership. The survey results have shown that all of these three operational marketing strategies are very important to the firms in the sample with customer retention having the highest mean score. This supports Bruggeman and Van der Stede (1993) who believed multiple strategies were possible.

Given this finding, the literature prescribed that firms should have a customer profitability analysis system in place to support the strategy, yet 44% of respondents did not have these systems. This finding supported the case study results.

The reasons for firms not having customer profitability analysis are: it is difficult to determine customer costs; customer revenue information is sufficient; it is difficult to determine customer revenues; there is no champion for accounting innovations; a lack of existing labour skills to implement the system; accounting and marketing do not work well together and marketing staff did not ask for it. In addition, industry type has some influence and larger organisations adopt CPA more readily.

Despite relatively high levels of satisfaction with accounting systems, all respondents ranked customer revenue, customer cost and customer profitability analysis information as important, suggesting that there is further opportunity for the development of these systems in New Zealand organisations, as well as future research tracing this development.

We now turn to Chapter fifteen, the conclusion of this thesis.

Chapter Fifteen: Conclusion

Introduction

Phillips and Pugh (1994, 34) claim that one way in which a PhD thesis can make a contribution to knowledge is through “looking at areas that people in the discipline haven’t looked at before.” This research has undertaken a contingent examination of the interface between a marketing strategy and a cost system, namely customer retention and customer profitability analysis. This has not been undertaken in the management accounting contingency literature before.

In this final chapter, the major conclusions of this research are presented. Implications for further research and practice are provided. A summary concludes the thesis.

Conclusions

Initially, from the literature presented in chapters two to four it was believed that if a firm follows a customer retention strategy then information from a customer profitability analysis system would be in place to support that strategy. However, this research found that mitigating factors appear to affect this relationship: the strategy-cost system fit is contingent.

The relationship between customer retention and customer profitability analysis is not as straight forward as the literature implies. Industry type and size create

obstacles which hinder the ability of firms to base a customer retention strategy on information on profitable customers using customer profitability analysis.

In the case study sites, the bank, and the manufacturing and courier companies base their customer retention strategy on customers determined by revenue rather than profitability, even in the bank, where there was a customer profitability analysis system in place. This result was backed up further in the survey, where one of the most important reasons for not having a customer profitability analysis system in place was because customer revenue information was seen as sufficient.

Information from a customer profitability analysis system can help a firm understand the relationship between customer retention and firm profitability but many firms find it difficult to determine customer costs. Both case study and survey evidence point to the difficulty for firms in determining customer costs. Also many of the systems in use rely on direct customer costs only – systems resembling first generation analysis. Foster and Gupta (1994) criticised firms for using this simple analysis, yet the majority of firms in New Zealand do use it.

Other, although less important, factors influencing firms to not have a customer profitability analysis system include difficulties in determining customer revenues, the lack of champions for accounting innovations, marketing staff not asking for the systems, accounting and marketing not working well together and the lack of existing labour skills to implement the system.

Despite firms following a customer retention strategy, many without customer profitability analysis, firms exhibit relatively high degrees of satisfaction with

their accounting systems to support their retention strategies, whether they have customer profitability analysis or not.

Future Research

This research is the first using contingency theory to consider alternative strategy paradigms and cost systems rather than management control, and new contingent factors were identified as affecting the fit. Future research should focus on providing further evidence on the contingent factors identified here as affecting this marketing-cost system relationship and other strategy-structure paradigms.

Further, it needs to be determined whether customer profitability analysis information is really necessary. Many of the firms in this research see customer retention as a very important strategy, yet these firms substitute customer profitability information with customer revenue information (Fisher 1995); thus the substitutability theory seems to apply. The respondents also indicate relatively high levels of satisfaction with their accounting systems. Further research could examine categories of strategy and cost system alternatives.

What appears important is that there be alignment between the strategy in place and the management accounting system supporting that strategy. For example, in this research the manufacturing firm is following a brand loyalty strategy and the management accounting system offers information on brand profitability and shelf space profitability. In this case, the strategy and the management accounting systems “fit”. Also the firms in the survey used substitutes for customer profitability analysis: customer revenue or customer cost. Marketing and

management accounting “fit” issues still require further investigation, particularly in light of the apparent difficulties of getting these two functions to work together as described in chapter fourteen.

Despite recommendations in the literature (see chapter four) that firms should use customer profitability analysis information to support their marketing strategy, three of the four case study firms categorise best customers based on customer revenue. At the bank this is the case even when there is a customer profitability analysis system in place. One of the reasons for the lack of use of customer profitability information is the difficulty of predicting lifetime revenues and costs. In the survey firms only 13% of users of customer profitability analysis incorporated life-cycle costs into the models. Further research is required to gain a better understanding of firms which have succeeded in predicting lifetime revenues and costs. The literature has recommended this level of sophistication in customer profitability analysis systems, yet this research has shown that achieving this level of sophistication is difficult, and hence greatly affects the ability of the firm to use the information as recommended in the literature.

In terms of customer profitability analysis systems, it appears that there is still much to be learned. There is a gap between what the marketing and management accounting literature says should be done and what is being done. Further research, as these systems develop, needs to be encouraged to avoid a continuation of the criticism of management accounting theory and practice leveled in the early 1980’s which Drury (1997, 100) reiterates: “In the early

1980's a gap between theory and practice of management accounting came to be recognized.”

Implications for Practice

Many management accounting academics believe it essential that academic research have implications and relevance to practice (Johnson and Kaplan 1987, Drury and Tayles 1995, Drury 1997), and the very purpose of contingent based research is to “provide insight on the array of management control systems found in practice [which] should help to increase the effectiveness of organizations by improving the control system choice” (Fisher 1995, 44). This research does provide such implications.

Once a decision has been made to follow a retention strategy, it has been suggested that a customer profitability analysis system be in place to support that strategy. Information from the system can be used to assess the success of the retention strategy on firm profitability – a useful resource. However, the ability of the system to do this is affected by the accuracy of the information which depends on the level of cost analysis included in the model. Firms are advised to invest the resources to try and achieve the most accurate customer profitability figures. As was shown in chapter three, activity based costing principles, applied to customer costs, can help increase the level of accuracy of the information.

There is one final implication for practice that this research has revealed. The four case firms in this study had management accounting information systems

aligned with the strategies selected and in all cases the firms were achieving desired performance outcomes – in some cases in turbulent economic environments. Firms are encouraged to ensure such alignment, but evidence presented here suggests that more than one management accounting information system can be used; for example, customer revenue can substitute for customer profitability.

Research Limitations

This research used a multiple case study approach in the first instance and a survey in the second. The use of multiple data collection techniques has helped to limit many potential limitations of either method. The survey flowed from the case study research, allowing the qualitative evidence to be tested. The theory development and testing cycle is completed.

Summary

The research reported in this thesis provides evidence on the contingent nature of the relationship between customer retention and customer profitability analysis.

Customer retention is a very important strategy to many businesses. Where that strategy is followed, information from a customer profitability analysis system may be used to support the strategy. However, firms can, and do, follow a retention strategy with alternative management accounting information systems and are satisfied with the strategy-cost system fit.

This research has answered the calls by Foster and Young (1997) and Shields (1997) for research examining the relationship between management accounting and marketing issues. It also has opened up opportunities for further research for examining how management accounting can support marketing strategy more effectively, and how it can help us understand the relationship between following a particular marketing strategy and a firm's reliance on management accounting information.

It has also provided theoretical refinement of the contingent literature in management accounting by considering an alternative strategy-structure paradigm (Anderson and Lanen 1999) relying on both case study and survey analysis. (Otley and Pollanen 2000). This research thus makes an original contribution to the development of management accounting knowledge.

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Appendix One: Introductory Letter

1 October 1998

My name is Yvonne Shanahan and I am a Senior Lecturer at the University of Canterbury, researching and teaching in management accounting.

I am currently undertaking a major piece of research which is examining the interaction of management accounting and marketing, the results of which provide input into our student learning. I can provide a detailed proposal on request.

What the research requires is approximately two hours. I would need to ask approximately twenty questions of the marketing manager, and a similar amount of questions from the chief accountant. Participants in the study to date have used email to answer the questions. This means that the participants can answer the questions in their own time but I am quite willing to come and carry out a personal interview if participants prefer.

Confidentiality of the organisation will be assured. I am looking for general trends, not to write a specific statement about any particular organisation.

I hope your organisation can participate. I will call you next week to follow this letter up or alternatively you can email me or call me. Thank you for your time and I look forward to meeting with you very soon.

Warm regards

Yvonne P. Shanahan
Senior Lecturer in Management Accounting

Appendix Two: Email and Personal Interview Questions

Interview questions for Marketing

- 1 Does the firm follow a customer retention strategy – that is a strategy to maintain and retain existing customers?
2. Would you say that this is the firm's dominant strategy? How long has the firm been following it?
3. Is the customer retention strategy formalised in a customer retention plan or informally undertaken?
4. Can you describe the key components of your customer retention strategy?
5. Does it include the following:
 - a focus on employee retention?
 - a formal or informal plan?
 - is compensation/performance evaluation tied to retention?
 - is there extensive training in service quality?
6. Does your firm monitor customer needs? How?
7. How does it act on that information?
8. Do you use any of the following customer retention techniques?
 - Toll free telephone numbers?
 - Call backs?
 - Customer Clubs?
 - Loyalty Discounts?
 - Comment Cards?
 - Cross Selling?

- Recognition Letters of appreciation of custom?
 - Satisfaction Guarantees?
 - Feedback from Customers?
9. Do you have an information system which supports your retention strategy (e.g. a customer profitability analysis system, others?)
 10. Do any of these systems collect information on customer demographics, spending patterns, product needs, causes of customer defections?
 11. Do you calculate customer retention rates? How? (Examples: Share of revenue from repeat sales to existing customers compared to sales to first time customers and/or share of each customer's requirements purchased from the company as opposed to competitors?)
 12. Do you set target customer retention rates and compare actual rates to budgeted rates?
 13. What factors influence the firm to follow a customer retention strategy
 - It lowers costs associated with long time customers?
 - It reduces cost associated with replacing lost customers?
 - The purchase of a wider line of company products by long time customer results in economies of scale?
 - Increased revenue from Referrals?
 - Others?
 14. Do you use customer profitability information to support your customer retention strategy?
 15. Do you believe there is a relationship between following a customer retention strategy and the profitability of the firm? Can you describe that relationship?
 16. How do you know the relationship exists? Does Customer Profitability information help you to understand this relationship?
 17. Do you believe it is easy to directly relate customer satisfaction or customer loyalty measures to accounting profits?
 18. Do you tailor marketing strategies to reflect the appropriate balance between new and retained customers?

19. Are you able to breakdown total firm profits into customer profits? Yes/No? Example?
20. Have you seen over time a reduction in profit from new customers compared with profits from retained customers?
21. Has the firm's profit been increasing over time? Could I have evidence? (E.g % increase not net profit figures?)
22. Do you use customer profitability (CPA) information to support your marketing strategy? Who is using the information?
23. Do you use CPA information for price negotiation?
24. Do you use CPA information for segmentation?
25. Do you use CPA information for cross selling?
26. Do you use CPA information for analysing customer behaviour – do you categorise customers e.g. target, convert, retain, drop?
27. Do you use CPA information for managing the customer relationship? – productivity improvements inside the firm and account engineering – changing the way customers do business?

Management Accounting and Marketing Interface Follow Up Questions

28. Do you believe that the marketing and accounting functions interact well in your organisation?
29. Do you think your knowledge of accounting is sufficient to request the appropriate information that you need from your accounting department?
30. Do you think it is important for marketing staff to understand the cost impact of marketing decisions?
31. Do you believe that management accountants can provide you with this information?
32. Does your organisation foster a team concept that is, organisational functions working together?

Thank you for your time.

Interview Questions for Finance

1. Does your firm have a customer profitability analysis (CPA) system. (If the firm does not have a CPA system then go to question 10. If it does, continue with all questions.)
2. Can you describe the CPA system generally? How long has it been in operation?
3. Does the CPA system calculate cost hierarchies that is, does it break down costs into customer specific, general customer and general corporate costs? What happens to indirect and general corporate costs? Does the new system distinguish between direct and indirect costs?
4. Does the system incorporate the lifetime value of a customer?
5. If so, do you feel confident with your predictions of lifetime revenues and costs?
6. Does the system distinguish between short term and long term costs?
7. Do you include activity costs? Have you applied activity based costing principles to understand costs? For example, have you undertaken activity analysis to increase the accuracy of tracing?
8. Are you using this information to minimise activity costs?
9. Do you use standard costs for products?

Use of CPA and or other accounting information to support the firm's marketing strategy?

10. Is the firm using information from a CPA model to support its marketing strategy? (If no what other accounting information is provided to marketing?)
11. Is CPA information or other accounting information provided for price negotiation?
12. Is CPA information or other accounting information provided for segmentation?
13. Is CPA information or other accounting information provided for cross selling?

14. IS CPA information or other accounting information provided for analysing customer behaviour – do you categorise customers e.g. target, convert, retain, drop?
15. Is CPA information or other accounting information provided for managing the customer relationship? – productivity improvements inside the firm and account engineering – changing the way customers do business?
16. Does your firm follow a customer retention strategy – a strategy to retain existing customers?
17. Do you believe that following such a strategy will lead to increased profitability of the firm?
18. How do you know?
19. Do you believe it is easy to directly relate customer satisfaction or customer loyalty measures to accounting profits?
20. What do you think drives profitability in your firm?
21. Do you determine customer contribution?
22. Do you calculate a time series customer defection rate?
23. Do you assess the expected value of new customers?
24. Do you constantly assess the existing customer base?
25. Do you project future total contribution of the firms customer base?
26. Do you tailor marketing strategies to reflect the appropriate balance between new and retained customer?
27. Do you have a CPA system able to breakdown total firm profits into customer profits? If so can I have an example?
28. Have you seen over time a reduction in profit from new customers when compared with profits from retained customers?
29. Has profit been increasing over time? Could I have evidence?

Management Accounting and Marketing Interface Follow-Up Questions

30. Do you believe that the marketing and accounting functions interact well in your organisation?

31. Do you think your knowledge of accounting is sufficient to request the appropriate information that you need from your accounting department?
32. Do you think it is important for marketing staff to understand the cost impact of marketing decisions?
33. Do you believe that management accountants can provide you with this information?
34. Does your organisation foster a team concept that is, organisational functions working together?

Thank you for your time.

Appendix Three: Survey Questionnaire

1. Organisation Details

(a) Industry Type

- Agriculture, Forestry and Fishing ☐
- Mining ☐
- Manufacturing ☐
- Electricity, Gas and Water Supply ☐
- Construction..... ☐
- Wholesale Trade..... ☐
- Retail Trade ☐
- Accommodation, Cafes and Restaurants..... ☐
- Transport and Storage ☐
- Communication Services..... ☐
- Finance and Insurance ☐
- Property and Business Services..... ☐
- Cultural and Recreational Services ☐
- Personal and Other Services..... ☐
- Other: please state ☐

(b) Number of Employees

- 0 ☐
- 1-10..... ☐
- 11-20..... ☐
- 21-30..... ☐
- 31-50..... ☐
- 51-100..... ☐
- 101-200..... ☐
- 201-300..... ☐
- 301-400..... ☐
- 401-500..... ☐
- >500..... ☐

2. Please indicate the degree to which your firm considers the following marketing strategies to be important. A 1 indicates that the strategy is not important while a 5 indicates it is very important:

		Not Important		Very Important	
		1	2	3	4
(a)	Customer retention	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b)	Customer acquisition	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c)	Brand leadership	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d)	Other: please state	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

3. Does your firm collect and **use** the following management accounting information systems to support its marketing strategy. Please tick relevant boxes and make additional comments if desired:

		Yes	No
(a)	Sales by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>
(b)	Costs by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>
(c)	Profitability (i.e., sales less costs) by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>
(d)	Others: please list		

4. If you **use** a customer profitability analysis system (ie 3(c) above) indicate which costs are allocated to customers:

		Yes	No
(a)	Direct customer costs	<input type="checkbox"/>	<input type="checkbox"/>
(b)	Indirect customer costs	<input type="checkbox"/>	<input type="checkbox"/>
(c)	Lifetime customer costs	<input type="checkbox"/>	<input type="checkbox"/>
(d)	General costs	<input type="checkbox"/>	<input type="checkbox"/>
(e)	Corporate costs	<input type="checkbox"/>	<input type="checkbox"/>

5. Whether your firm **uses** the following management accounting information systems **or not**, please rate your perception of the **importance** of each system in supporting marketing strategy. A 1 means the system is not important and a 5 means the system is very important:

		Not Important			Very Important	
		1	2	3	4	5
(a)	Sales by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b)	Costs by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c)	Profitability (ie sales less costs) by customer or customer group	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d)	Other: please state	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

6. If you **do not use** customer profitability analysis please indicate what factors influence this decision? A 1 indicates that a factor is not important while a 5 indicates it is very important:

		Not Important		Very Important		
		1	2	3	4	5
(a)	It is difficult to determine customer revenues	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b)	It is difficult to determine customer costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c)	the firm does not have a champion for accounting innovations	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d)	Marketing staff did not ask for it	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(e)	Accounting and marketing do not work well together	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(f)	The firm does not have the existing labour skills to implement the system	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(g)	Customer revenue information is sufficient	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(h)	Other: please state	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7. Are you satisfied with the current level of accounting information system support for the firm's operational marketing strategy? A 1 means you are dissatisfied and a 5 means you are very satisfied:

Dissatisfied			Very satisfied	
1	2	3	4	5
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Thank you for completing the questionnaire. Please return it in the postage paid envelope provided.

Appendix Four: Survey Questionnaire Cover Letter - First Mailing

23 April 2001

My name is Yvonne Shanahan and I am a Senior Lecturer in Management Accounting at the University of Canterbury.

The **Institute of Chartered Accountants of New Zealand** has provided funds for this research, which seeks to examine the use of management accounting information systems to support marketing strategy. Attached is a brief questionnaire, which should only take a few minutes of your valuable time. I hope you will participate. The results of surveys of New Zealand business practices help us to keep our courses current, which feeds back into industry with better-informed graduates.

I thank you for your time.

Yvonne Shanahan

Senior Lecturer in Management Accounting

Appendix Five: Survey Questionnaire Cover Letter - Second Mailing

14 May 2001

My name is Yvonne Shanahan and I am a Senior Lecturer in Management Accounting at the University of Canterbury. On the 23 April 2001 I sent you a letter with an accompanied questionnaire seeking your input to a survey of management accounting practice. Many people have responded to date, but I would appreciate your input as well.

I would like to remind you that The Institute of Chartered Accountants of New Zealand has provided funds for this research, which seeks to examine the use of management accounting information systems to support marketing strategy. Attached is another copy of the brief questionnaire, which should only take a few minutes of your valuable time. I hope you will participate after this second request. The results of surveys of New Zealand business practices help us to keep our courses current, which feeds back into industry with better-informed graduates.

I thank you for your time.

Yours faithfully

Yvonne Shanahan

Senior Lecturer in Management Accounting

Appendix Six: Survey Questionnaire Non-Response Letter - Third Mailing

11 June 2001

My name is Yvonne Shanahan and I am a Senior Lecturer in Management Accounting at the University of Canterbury. On 23 April and 14 May I sent you a letter with an accompanying questionnaire seeking your input to a survey of management accounting practice. To date you have not responded.

I would still appreciate your response. However if you cannot return the questionnaire would you please tick any of the boxes below explaining your reason/s why and return this letter in the prepaid envelope provided.

Reason	Tick if applicable
The questionnaire was sent to two people in our organisation and we sent one response which reflected this firm's point of view.	
I do not consider the questionnaire to be applicable to our organisation.	
We have a standard firm policy of not responding to questionnaires.	
I do not have time.	
Other.....	

I thank you for your time

Yvonne Shanahan